

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 8, 2011

Volume 4 Issue 173

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- Low volume on big up days can be problematic. Less so in recent years.
- Same goes for the reduced number of new highs despite Wednesday's strong price advance.
- The 1-day price action doesn't provide appealing equity curves, but the 2-day pattern suggests a bearish edge.

## *Short-term Outlook*

### *The Bottom Line*

The strong move higher has led to a quick reversal in the Aggregator. It now appears the market is likely to pull back over the next few days. I am looking to position myself short to take advantage of this.

**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 8, 2011	Close 4% above yesterday's 1% gap down	1-2 days	Bearish	
September 7, 2011	2% Gap Down Partial Fill. C>O, C<200ma	1-2 days	Bullish	
September 6, 2011	1% drop prior to 3-day US weekend	1-4 days	Bearish	-3.20%
<b>Active - Long Term</b>				
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%
<b>Dropped Tonight</b>				
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	

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

***The Evidence***

The bullish inclinations we saw last night played out very strongly on Wednesday. The market gapped up substantially to open the day and never looked back. It opened near its lows and closed near its highs. In the end the SPX gained 2.9%, the NASDAQ was up 3.0%, and the Russell 2000 rose 4.2%. Breadth was extremely strong as the NYSE Up Issues % came in at 89% and the Up Volume % was 95%. Total NYSE volume was weak, though, and came in at the lowest level in over a week.

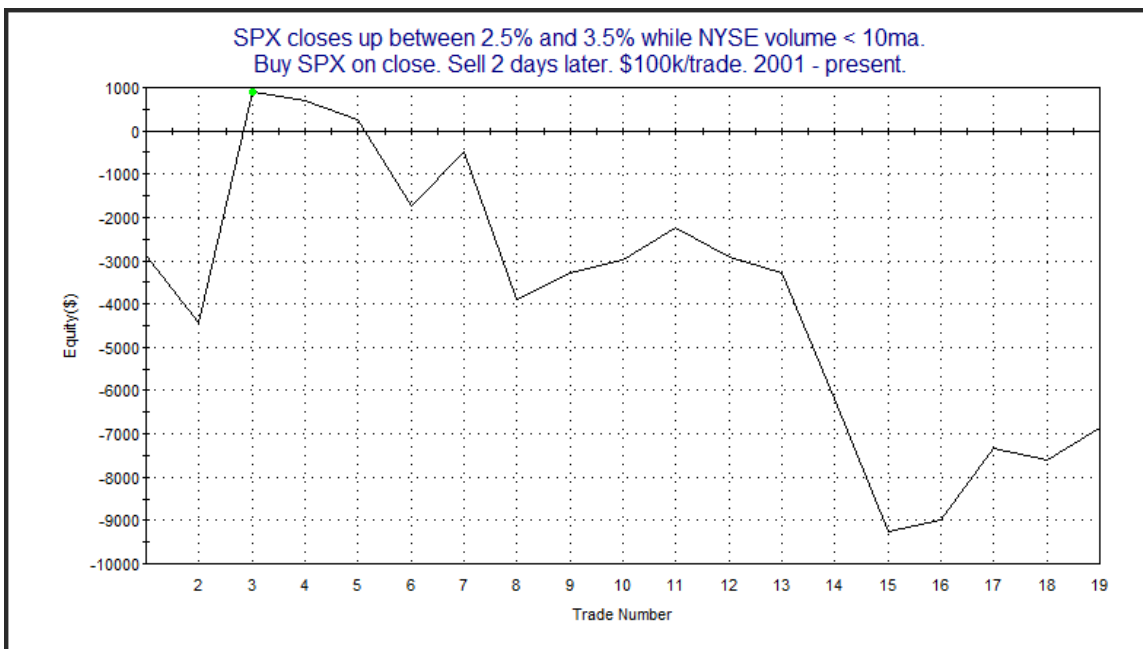
The Quantifinder identified a good number of studies tonight that initially appeared bearish. Upon further examination several of them appear to have lost their edge in recent years. I'll go over some of tonight's findings related to this and then show a couple of new studies that do appear to suggest a short-term bearish edge.

Low volume during a strong rally can sometimes suggest the rally doesn't have much behind it and a pullback is imminent. The study below is from the 6/11/10 subscriber letter. It looked at other days where the SPX posted very large gains on below average volume. The results have all been updated.

SPX closes up between 2.5% and 3.5% while NYSE volume < 10ma.  
Buy SPX on close. Sell X days later. \$100k/trade. 2001 - 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	-6,527.21	12	5	7	41.67	4,018.73	-3,802.98	1.06	0.75	-543.93
9	-13,658.93	14	7	7	50.00	3,305.26	-5,256.54	0.63	0.63	-975.64
8	-20,561.30	14	6	8	42.86	2,784.45	-4,658.50	0.60	0.45	-1,468.66
7	-7,613.88	14	6	8	42.86	3,784.49	-3,790.10	1.00	0.75	-543.85
6	-20,686.60	15	6	9	40.00	3,825.97	-4,849.16	0.79	0.53	-1,379.11
5	-12,039.81	16	8	8	50.00	2,981.71	-4,486.69	0.66	0.66	-752.49
4	3,325.40	17	7	10	41.18	3,773.17	-2,308.68	1.63	1.14	195.61
3	-5,970.33	18	7	11	38.89	3,151.17	-2,548.05	1.24	0.79	-331.69
2	-6,876.23	19	8	11	42.11	1,363.72	-1,616.91	0.84	0.61	-361.91
1	-2,024.08	19	10	9	52.63	936.56	-1,265.52	0.74	0.82	-106.53

Last time I showed this study the statistics appeared substantially more bearish. Focusing on the 2-day results I generated an equity curve below.



Results here have never been terribly consistent but the rise on the right side of the chart is now longer than any other rise. When the market rallied last September I recall there were several volume-related bearish studies that were triggering. The rally last fall steamrolled all of these bearish studies despite its continually low volume. Explanations I've heard for why the market has been able to put together strong rallies in the past couple of years on very low volume include 1) Quantitative Easing created an artificial

floor allowing prices to rally even without visible exchange volume, and 2) the fact that so much volume has moved off the floor of the exchanges and is not easily accounted for. The reason isn't important to me. What is important is that I keep in mind that the market is always evolving and because of this, studies like this one need to be continually monitored.

Another study that now appears to be losing some effectiveness is from the 7/8/10 subscriber letter. It looked at strong moves higher that were not accompanied by an expansion in new highs. Previously I had shown results on all way back to 1970. Upon further examination tonight it appeared that the downside edge didn't become apparent until around 2002. Below are updated results covering 2002 – present.

**Today's SPX high is at least 1.5% above yesterday's high but the number of NYSE new highs declines. 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
10	-21,463.85	8	3	5	37.50	5,405.80	-7,536.25	0.72	0.43	-2,682.98
9	-23,391.31	8	3	5	37.50	4,407.09	-7,322.51	0.60	0.36	-2,923.91
8	-28,379.01	8	2	6	25.00	3,387.46	-5,858.99	0.58	0.19	-3,547.38
7	-25,981.05	9	3	6	33.33	3,001.37	-5,830.86	0.51	0.26	-2,886.78
6	-13,616.94	9	5	4	55.56	3,417.01	-7,675.50	0.45	0.56	-1,512.99
5	-9,306.28	11	5	6	45.45	5,900.74	-6,468.33	0.91	0.76	-846.03
4	-14,832.41	11	5	6	45.45	4,361.74	-6,106.85	0.71	0.60	-1,348.40
3	-1,775.80	11	5	6	45.45	4,194.11	-3,791.06	1.11	0.92	-161.44
2	-14,923.75	12	7	5	58.33	2,483.73	-6,461.97	0.38	0.54	-1,243.65
1	-22,371.74	13	3	10	23.08	1,881.81	-2,801.72	0.67	0.20	-1,720.90

The stats here appear to suggest a short-term downside edge. The first day is the main culprit causing most of the damage. But a closer look at the instances in the list below shows that recent occurrences have not been the layup they once appeared to be.

Today's SPX high is at least 1.5% above yesterday's high  
but the number of NYSE new highs declines.  
Buy SPX on close. Sell X days later. \$100k/trade. 2002 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
07/24/02	Buy	\$843.43	(0.56%)	\$1,227.20
07/25/02	Sell	\$838.68		(\$3,223.76)
09/11/02	Buy	\$909.45	(2.48%)	\$0.00
09/12/02	Sell	\$886.91		(\$2,675.95)
10/13/08	Buy	\$1,003.35	(0.53%)	\$4,055.04
10/14/08	Sell	\$998.01		(\$3,096.72)
10/14/08	Buy	\$998.01	(9.03%)	\$0.00
10/15/08	Sell	\$907.84		(\$9,316.00)
10/28/08	Buy	\$940.51	(1.11%)	\$3,105.80
10/29/08	Sell	\$930.09		(\$1,934.50)
10/31/08	Buy	\$968.75	(0.25%)	\$702.46
11/03/08	Sell	\$966.30		(\$1,022.79)
11/04/08	Buy	\$1,005.75	(5.27%)	\$0.00
11/05/08	Sell	\$952.77		(\$5,533.11)
11/13/08	Buy	\$911.29	(4.17%)	\$609.31
11/14/08	Sell	\$873.29		(\$4,513.69)
11/24/08	Buy	\$851.81	0.66%	\$2,004.21
11/25/08	Sell	\$857.39		(\$1,967.94)
01/02/09	Buy	\$931.80	(0.47%)	\$516.81
01/05/09	Sell	\$927.45		(\$1,312.89)
03/04/09	Buy	\$712.87	(4.25%)	\$0.00
03/05/09	Sell	\$682.55		(\$4,891.60)
03/11/09	Buy	\$721.36	4.07%	\$4,315.26
03/12/09	Sell	\$750.74		(\$910.80)
07/07/10	Buy	\$1,060.27	0.94%	\$1,032.12
07/08/10	Sell	\$1,070.25		(\$190.82)

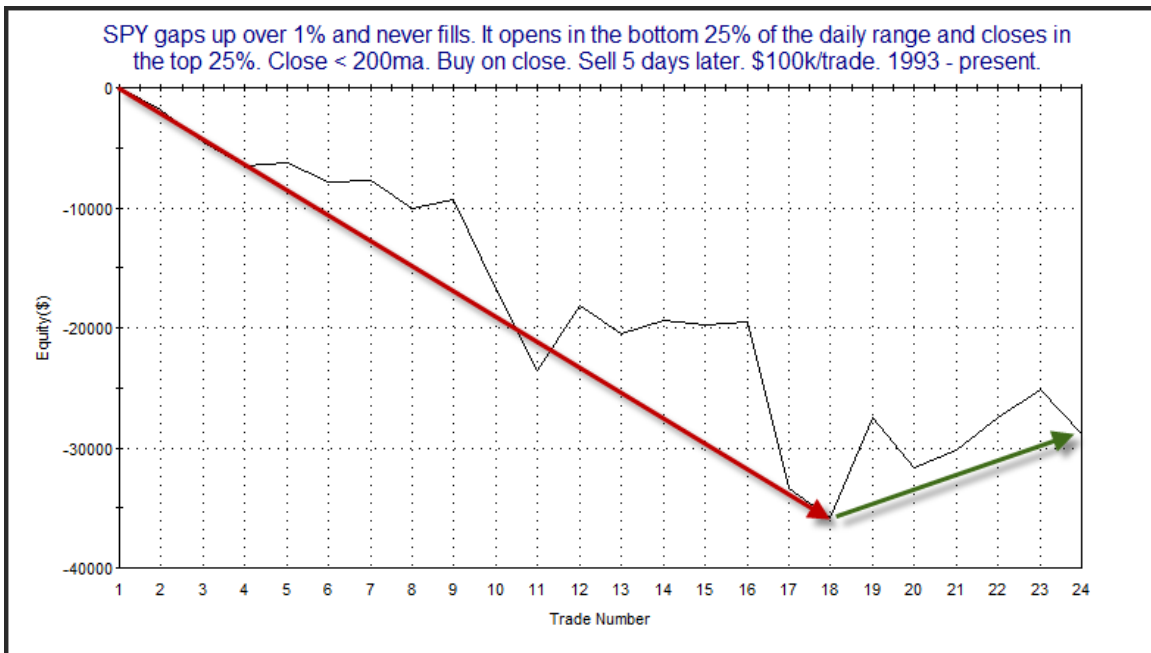
I don't intend to kick this study to the curb just yet but I'm not including it in the aggregator tonight. I would rather wait a bit to see how the next few instances pan out.

Lastly from the Quantifinder we were treated to the study below which was last shown in the 9/2/10 subscriber letter. It looked at instances under the 200ma where large gaps up kept running throughout the day. The statistics below are again updated.

SPY gaps up over 1% and never fills. It opens in the bottom 25% of the daily range and closes in the top 25%. 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
10	-16,851.48	19	8	11	42.11	3,912.32	-4,377.28	0.89	0.65	-886.92
9	-27,138.88	22	10	12	45.45	3,320.13	-5,028.35	0.66	0.55	-1,233.59
8	-37,502.34	22	10	12	45.45	2,829.88	-5,483.43	0.52	0.43	-1,704.65
7	-27,249.29	23	10	13	43.48	3,200.78	-4,558.24	0.70	0.54	-1,184.75
6	-25,139.59	23	7	16	30.43	4,279.27	-3,443.41	1.24	0.54	-1,093.03
5	-28,776.94	24	10	13	41.67	2,258.29	-3,950.76	0.57	0.44	-1,199.04
4	-24,267.12	24	12	12	50.00	1,626.40	-3,648.66	0.45	0.45	-1,011.13
3	-13,775.47	24	10	14	41.67	1,676.38	-2,181.37	0.77	0.55	-573.98
2	-13,551.03	25	12	13	48.00	1,636.23	-2,552.75	0.64	0.59	-542.04
1	-5,692.21	25	15	9	60.00	477.26	-1,427.90	0.33	0.56	-227.69

It appears there may be a downside edge, but again the equity curve is telling a different story.



While the first 18 instances appeared to suggest a bearish edge, the last six have failed to confirm that suggestion.

What is common among the studies above, aside from the fact that they all seem to be losing some effectiveness, is that they all rely on a 1-day price pattern. The studies below

instead examined the price pattern of the last two days. As you'll see, a move like we've seen over the last two days typically needs a short-term rest before attempting to continue higher.

One way to look at the pattern of the last two days is by focusing on the 2 unfilled gaps, the first of which was down and the second of which was up. The study does this and also requires a close above the high of two days ago, suggesting the reversal has been especially strong.

After posting an unfilled gap down yesterday SPY posts an unfilled gap up today. It closes > the high of 2 days ago. Close < 200ma. Buy on close. Sell 1 day later. \$100k/trade. 1993 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
04/05/94	Buy	\$44.81	0.00%	\$223.10
04/06/94	Sell	\$44.81		(\$691.61)
10/04/99	Buy	\$130.75	(0.09%)	\$863.32
10/05/99	Sell	\$130.63		(\$1,573.84)
10/22/99	Buy	\$130.09	(0.50%)	\$291.84
10/25/99	Sell	\$129.44		(\$1,029.12)
11/13/01	Buy	\$114.55	0.10%	\$741.20
11/14/01	Sell	\$114.66		(\$741.20)
11/27/02	Buy	\$94.28	(0.32%)	\$710.20
11/29/02	Sell	\$93.98		(\$540.60)
12/16/02	Buy	\$91.65	(0.87%)	\$98.19
12/17/02	Sell	\$90.85		(\$992.81)
03/18/08	Buy	\$133.63	(2.48%)	\$762.96
03/19/08	Sell	\$130.32		(\$2,685.32)
08/05/08	Buy	\$128.36	0.44%	\$732.26
08/06/08	Sell	\$128.93		(\$685.52)
03/23/09	Buy	\$82.22	(1.97%)	\$170.24
03/24/09	Sell	\$80.60		(\$2,079.36)

I am only showing the 1-day results here because beyond that no strong edge was apparent. Instances are a bit low here but risk/reward appears to strongly favor the downside.

Another study I conducted this afternoon can be found below. I looked for 2-day patterns where the first day posted a large gap down and made a low almost immediately, and then the market rallied and closed the second day strongly above the day 1 open and near the peak price of the 2-day range.

SPY gaps down over 1% yesterday. Today it closes over 4% above yesterday's open.  
 Yesterday's open is in the bottom 5% of the 2-day range and today's close is in the top 5%.  
 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	-10,691.21	9	4	5	44.44	2,951.29	-4,499.27	0.66	0.52	-1,187.91
4	-13,168.59	9	5	4	55.56	2,400.32	-6,292.54	0.38	0.48	-1,463.18
3	-11,138.20	9	4	5	44.44	2,081.09	-3,892.52	0.53	0.43	-1,237.58
2	-18,027.01	9	1	8	11.11	4,612.05	-2,829.88	1.63	0.20	-2,003.00
1	-16,518.02	9	3	6	33.33	652.21	-3,079.11	0.21	0.11	-1,835.34

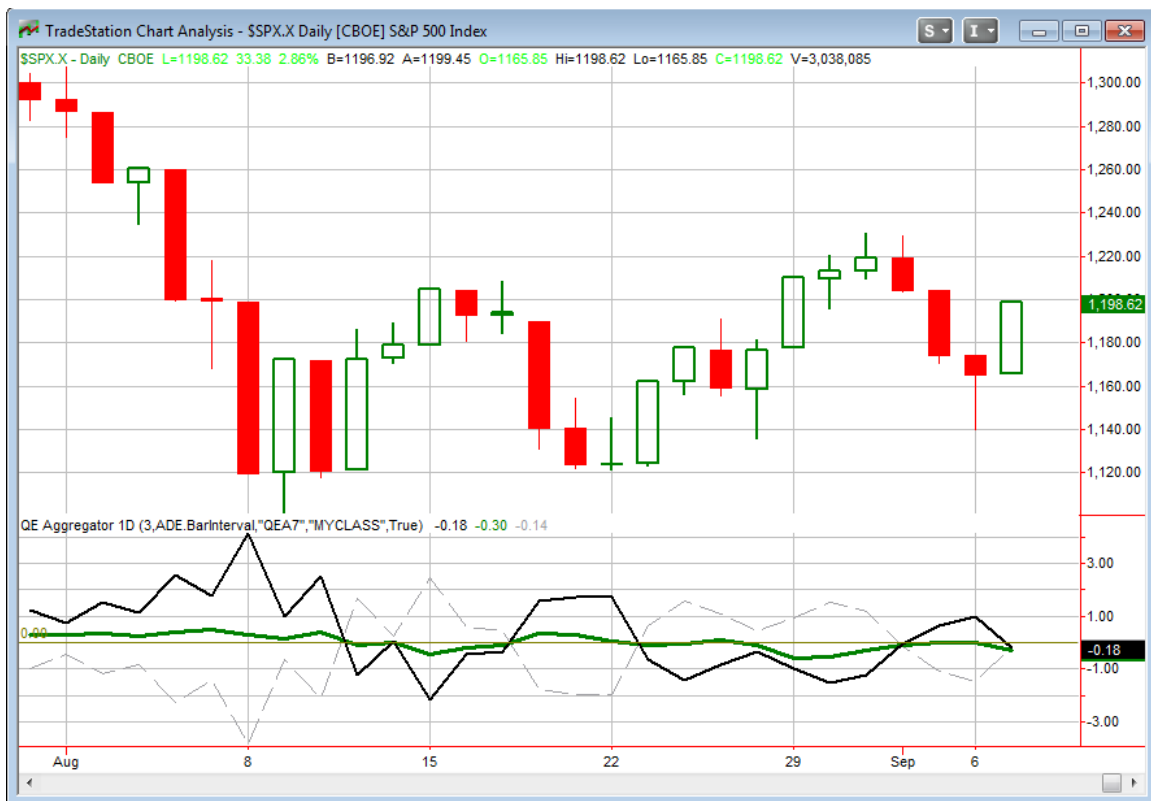
The limited number of instances appear to strongly suggest a short-term downside edge. Below I have listed all nine instances along with their 2-day results.

SPY gaps down over 1% yesterday. Today it closes over 4% above yesterday's open. Yesterday's open is in the bottom 5% of the 2-day range and today's close is in the top 5%. Buy on close. Sell X days later. \$100k/trade. 1993 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
01/13/98	Buy	\$95.31	(0.49%)	\$692.34
01/15/98	Sell	\$94.84		(\$618.91)
06/27/02	Buy	\$99.43	(2.41%)	\$1,075.35
07/01/02	Sell	\$97.03		(\$2,552.70)
10/15/02	Buy	\$88.70	(0.48%)	\$676.20
10/17/02	Sell	\$88.27		(\$3,133.06)
01/23/08	Buy	\$133.86	(0.61%)	\$2,166.30
01/25/08	Sell	\$133.04		(\$941.22)
02/01/08	Buy	\$139.52	(3.86%)	\$0.00
02/05/08	Sell	\$134.13		(\$4,188.60)
03/18/08	Buy	\$133.63	(1.16%)	\$762.96
03/20/08	Sell	\$132.08		(\$3,268.76)
10/20/08	Buy	\$98.81	(8.27%)	\$0.00
10/22/08	Sell	\$90.64		(\$11,415.36)
11/28/08	Buy	\$90.09	(5.35%)	\$0.00
12/02/08	Sell	\$85.27		(\$9,135.30)
03/10/09	Buy	\$72.17	4.61%	\$4,958.30
03/12/09	Sell	\$75.50		(\$470.90)

Unfortunately the lone loser was the most recent instance, but that doesn't change the overall message. I have included this study on the active list.

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



With only a few studies left on the board the green Aggregator line flipped back to negative from yesterday's positive reading. Levels below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the strong rally caused the Differential Line to dip 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 overbought versus recent expectations. This is considered a bearish configuration. Bearish configurations can be seen on the chart whenever both lines close below 0. Due to this the Aggregator System changed from long to short at the close.

Based on the current studies the Aggregator line will again close below zero on Thursday. Of course with so few studies on the board this could easily change if bullish evidence emerges. Meanwhile, the Differential Pivot will be 1,168.09. This is about 2.5% below Wednesday's close. So unless the SPX tanks at least this much on Thursday the Differential line will remain negative, suggesting an overbought market. So for the aggregator short signal to come off, it would likely require some bullish evidence on Thursday. If this happens then the most likely scenario is a flat signal, unless Thursday is a very large collapse.

The Aggregator has flipped, and so have I. I will now look to begin scaling in to a short position. Details are in the Trade Ideas section below.

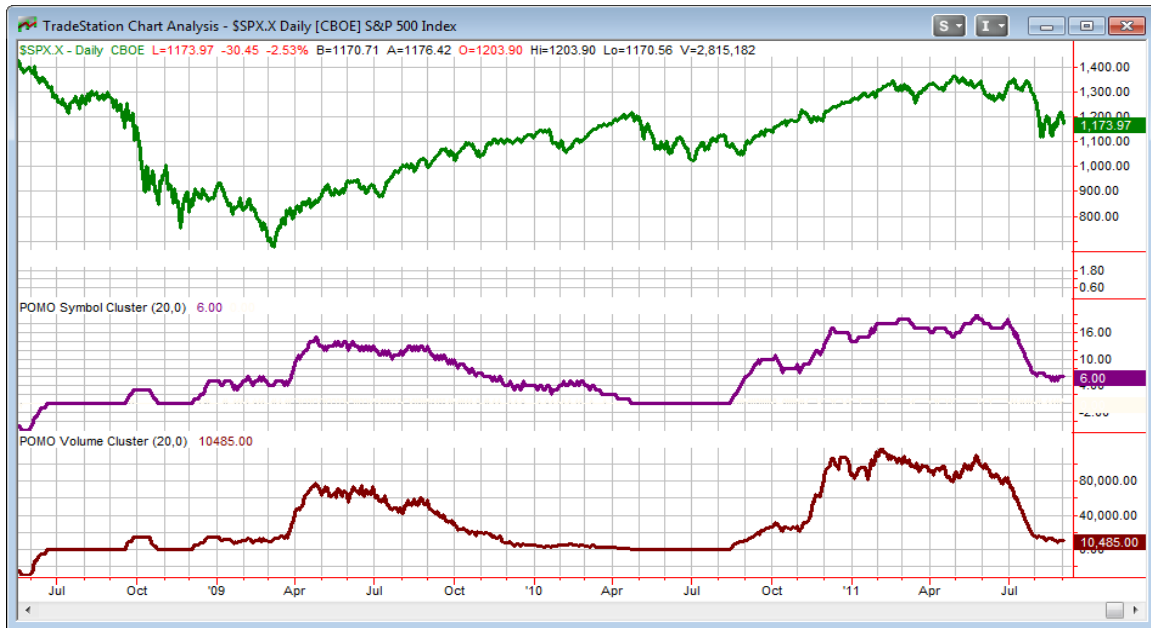
***Intermediate-term Outlook (2 weeks – 2 months)– updated 9/6 – slightly bearish***

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 3<sup>rd</sup> 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 \$14 billion 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.*

*[SPY](#) –short ¼ index position @ \$120.29 Limit. Based on short-term outlook above.*

### **Current Open Trade Ideas**

None.

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