

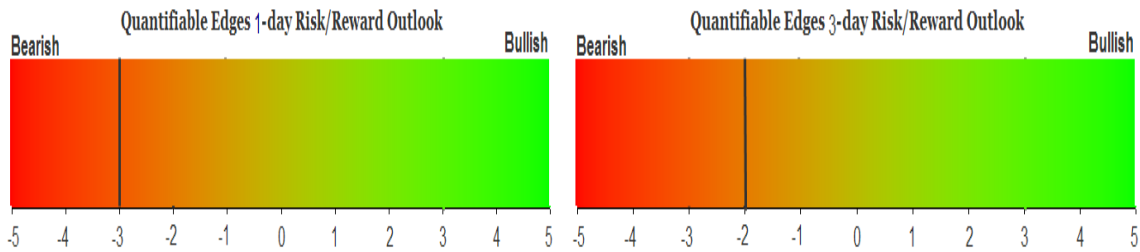
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 9, 2011

Volume 4 Issue 174

Market Overview



Signals Overview

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

Tonight's Research Points

- Sharp drops that only partially retrace gains from the day before are often followed by more selling the next day.

Short-term Outlook

The Bottom Line

I'm short and expect more downside. As volatile as the market has been lately I am inclined to lock in partial profits on my small position and let the 2nd half run its course.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
September 9, 2011	1% drop doesn't correct 3/4 of yest mov	1 day	Bearish	
September 8, 2011	Close 4% above yesterday's 1% gao down	1-2 days	Bearish	
September 6, 2011	1% drop prior to 3-day US weekend	1-4 days	Bearish	-3.20%
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				
September 7, 2011	2% Gap Down Partial Fill. C>O. C<2	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

A choppy day of trading finished poorly and the major indices all closed lower. The SPX lost 1.1%, the NASDAQ closed down 0.8% and the Russell 2000 fell 2.0%. Breadth was weak as the NYSE Up Issues % came in at 21% and the Up Volume % was 14%. Total NYSE volume came in just a little under Wednesday's level.

Sharp 1-day drops like today will often be followed by a bounce over the next few days. This has been especially true when the market is not coming off of new intermediate-term highs. The study below is from the 5/24/11 subscriber letter. I have actually shown it many times. Statistics are all up to date in the table below.

SPX closes down at least 1% and decliners double advancers. Yesterday 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	278,881.53	258	179	79	69.38	2,812.99	-2,843.60	0.99	2.24	1,080.94
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	171,510.53	393	243	150	61.83	1,823.41	-1,810.51	1.01	1.63	436.41
2	156,707.44	448	254	194	56.70	1,716.62	-1,439.77	1.19	1.56	349.79
1	123,132.13	502	296	206	58.96	1,148.34	-1,052.31	1.09	1.57	245.28

So as you can see the stats are all generally bullish. But today's 1% pullback was a bit different than many others because it followed a day where the market posted very strong gains. In the 6/1/10 subscriber letter I looked at other instances where a sharp drop occurred but the drop was not even able to erase as much as three quarters of the previous day's gains. I have updated the results of that study below.

SPX falls more than 1% but gives back less than 3/4 of yesterday's gains.
Buy on close. Sell X days later. \$100k/trade. 1987 - present.

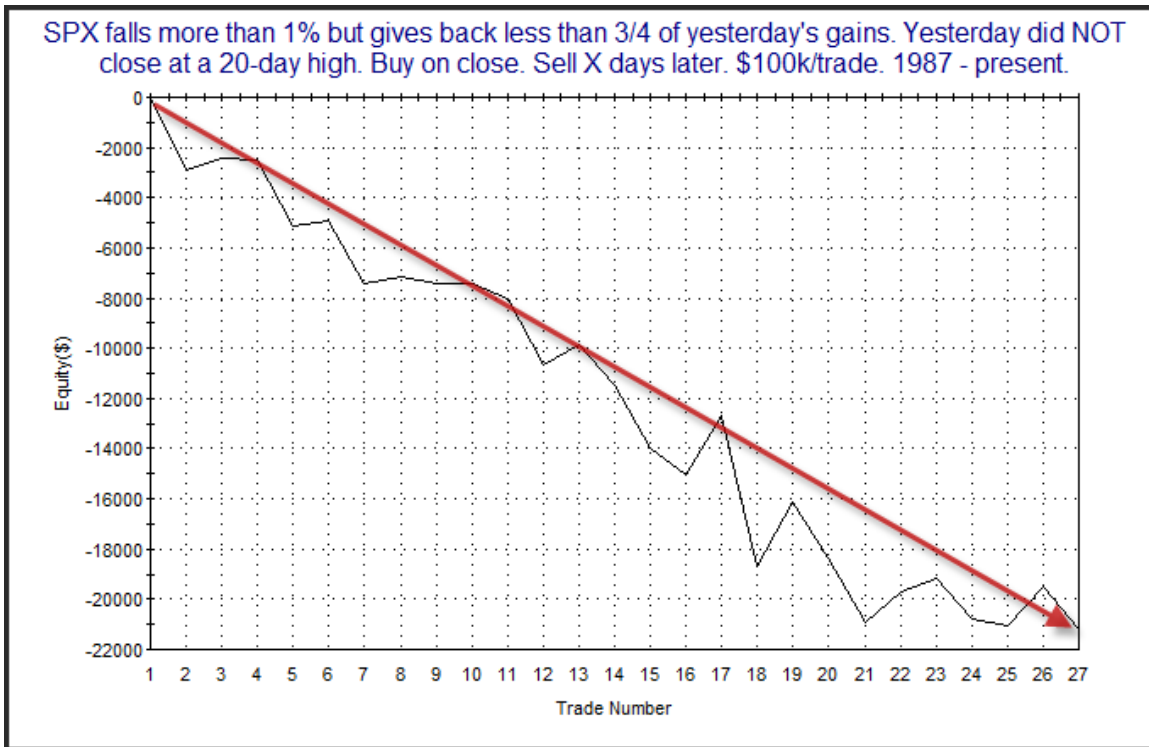
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	4,140.71	30	15	15	50.00	3,464.74	-3,188.69	1.09	1.09	138.02
4	-13,028.48	32	17	15	53.13	3,137.63	-4,424.55	0.71	0.80	-407.14
3	63.00	33	21	12	63.64	2,297.40	-4,015.20	0.57	1.00	1.91
2	-9,025.06	33	18	15	54.55	2,216.27	-3,261.20	0.68	0.82	-273.49
1	-18,257.26	33	13	20	39.39	1,155.34	-1,663.83	0.69	0.45	-553.25

Here we see that in most circumstances the market dip continues for another day before chopping around. I also thought it would be interesting to incorporate the 20-day high filter from the previous study into this one. If the strong move up the day before led to a 20-day high then that could suggest it was part of a breakout move. Below are the results with the 20-day high filter factored in.

SPX falls more than 1% but gives back less than 3/4 of yesterday's gains. Yesterday did NOT close at a 20-day high. Buy 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
5	-7,445.29	26	12	14	46.15	3,342.36	-3,396.69	0.98	0.84	-286.36
4	-22,965.46	27	12	15	44.44	3,616.90	-4,424.55	0.82	0.65	-850.57
3	-11,724.46	27	15	12	55.56	2,430.53	-4,015.20	0.61	0.76	-434.24
2	-23,249.42	27	13	14	48.15	1,908.51	-3,432.86	0.56	0.52	-861.09
1	-21,201.64	27	9	18	33.33	1,102.80	-1,729.27	0.64	0.32	-785.25

Not too many instances were eliminated using this filter, but their elimination does appear to push the stats even more bearish. The downside edge primarily plays itself out within one day. Below is an equity curve that assumes a 1-day holding period.



Looking at the equity curve the downside edge appears to be both consistent and strong. I have included this study on tonight's active list.

All of the short-term studies on the active list are now bearish, and they all expire after tomorrow. This means that expectations for Monday will be largely dependent upon Friday's action.

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



There wasn't much change to the Aggregator chart readings tonight. The green aggregator line remained moderately negative. Levels below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the Differential Line also remained 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 remained short at the close.

With all of the short-term studies expiring tomorrow, expectations for next week will be largely dependent upon what evidence emerges on Friday. If nothing compelling emerges expectations will remain mildly negative based on the intermediate-term studies. Meanwhile, the Differential Pivot will be 1,163.43. This is about 1.9% below Thursday's close. So unless the SPX closes down at least this much on Friday the Differential line will remain negative, suggesting an overbought market.

So the market put in a nice move in our direction today, and tonight's research suggests it is likely to fall even further. Because the market has been so choppy and volatile lately I am feeling a little cautious. It isn't something I often do, but I will look to lock in profits on a part of the position tomorrow.

Sometimes when a trade is going in my direction I begin to feel anxiety about whether I should exit and take my profits. Most of the time I prefer to just ride out positions until my exit signal is given. And in the long run this is the optimal way to trade. But there are occasions when I begin to get itchy about my holding and I yearn to get out. It doesn't matter if the position is a day-trade, a swing trade or an intermediate-term holding. The anxiety is often the same. When you feel anxiety during a trade, either because it is going your way like this trade, or whether it is going against you, the stress can cloud your decision making. Over the years I have found a great way to relieve anxiety about profit taking on winning trades is to simply exit part of the position. When I have done so, I have consistently felt relief that I was able to lock in some profit. Immediately afterwards I've been able to manage the remainder of my trade with a much clearer head.

The Aggregator has been nicely in sync with the market over the last few weeks, but with the size of the swings the market is experiencing, I'm anxious and will therefore look to take off a part of my position. Details are in the Trade Ideas section at the bottom of the letter.

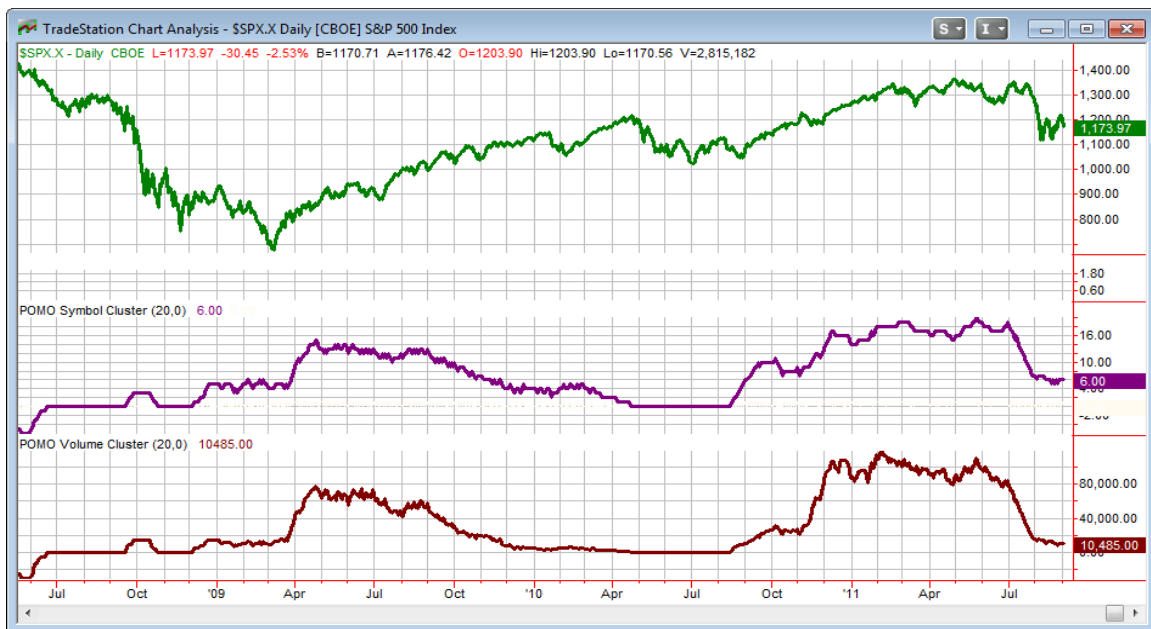
Intermediate-term Outlook (2 weeks – 2 months)– updated 9/6 – slightly bearish

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 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 \$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.

None tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	9/8/2011	\$120.29	\$119.04	1.04%		bought at limit

I will look to cover 1/2 of my SPY lot at a \$119.04 limit.

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