

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 13, 2011

Volume 4 Issue 176

Market Overview



Signals Overview

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

Tonight's Research Points

- When the VIX and SPX both close higher on a Monday and the SPX < 200ma, it is normally followed by a selloff.
- Weak bounces have a tendency to pull back rather than continue higher.
- The gap down, new short-term low, and reversal to close well for SPY has often been followed by a pullback over the next few days.

Short-term Outlook

The Bottom Line

While the SPX is still oversold, there no longer appears to be an upside edge. I'm looking to close out my long position and wait for the next favorable entry.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
September 13, 2011	Weak bounce after 2% drop.	1 day	Bearish	-3.80%
September 13, 2011	SPY gap down and reverse.	1-3 days	Bearish	-3.60%
September 13, 2011	SPX up. VIX up. Monday < 200ma	1-5 days	Bearish	
September 12, 2011	33.3% Up Issues. SPX < 200ma.	1-2 days	Bullish	3.00%
September 12, 2011	SPX down 2.5% on Friday	1-2 days	Bullish	2.70%
Active - Long Term				
September 12, 2011	Nasdaq leading SPX	int term	Bullish	
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%

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

The Evidence

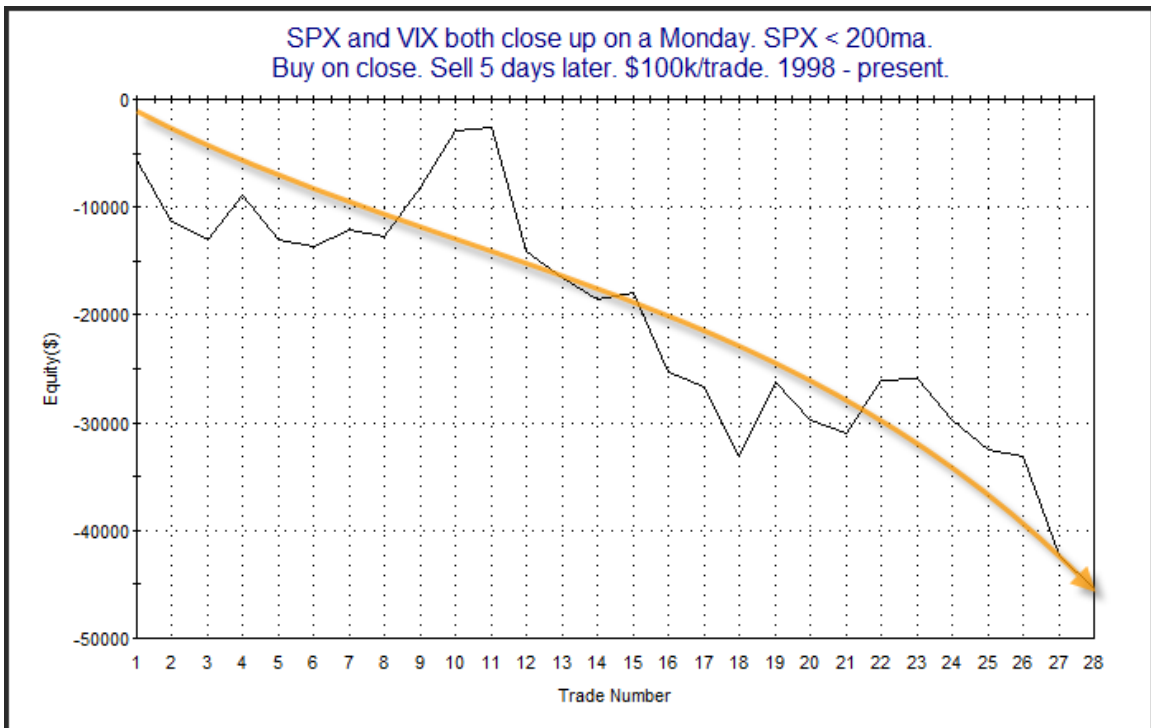
At 2:15 the SPX was down over 1.5%. It then began an afternoon rally that kept strengthening the nearer we got to the close. In the end the major indices all finished nicely higher. The SPX rose 0.7%, the Nasdaq gained 1.1% and the Russell 2000 rallied 0.9%. Despite the strong afternoon rally, breadth was mixed. The NYSE Up Issues % came in at 46% while the Up Volume % was 57%. Total NYSE volume dipped from Friday's levels.

When I ran the Quantifinder around 2:45 with the market down sharply it showed several bullish studies based on the strong oversold condition. As we approached the close and the SPX turn positive the studies shifted from positive to negative. I noted that expectations could flip when I posted the systems page a few minutes before the bell. I confirmed the negative expectations a few minutes after the bell. In the end the Quantifinder identified several bearish studies. I'll cover the most intriguing ones below.

The SPX and the VIX typically trade counter to each other, so it's a little unusual to see them both close higher as they did today. It does happen from time to time, and Monday is the most common day of the week for it to occur. This is because the VIX has a natural tendency to rise on Mondays. Even so, when it has occurred on Mondays it has typically suggested a short-term downside edge. The edge is more pronounced and lasts longer when the SPX is trading below its 200ma. I showed this in the 10/26/10 subscriber letter. Below is a copy of the study from that letter. Results have not changed.

SPX and VIX both close up on a Monday. SPX < 200ma. Buy on close. Sell X days later. \$100k/trade. 1998 - 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	-45,333.30	28	9	19	32.14	3,148.08	-3,877.16	0.81	0.38	-1,619.05
4	-30,934.75	29	10	19	34.48	2,865.57	-3,136.34	0.91	0.48	-1,066.72
3	-28,932.61	29	11	18	37.93	1,952.12	-2,800.33	0.70	0.43	-997.68
2	-19,158.02	29	12	17	41.38	1,620.77	-2,271.02	0.71	0.50	-660.62
1	-11,090.78	29	12	17	41.38	1,305.36	-1,573.83	0.83	0.59	-382.44

As you can see, the statistics appear to suggest a downside edge. To confirm this edge, I have produced an equity curve below.



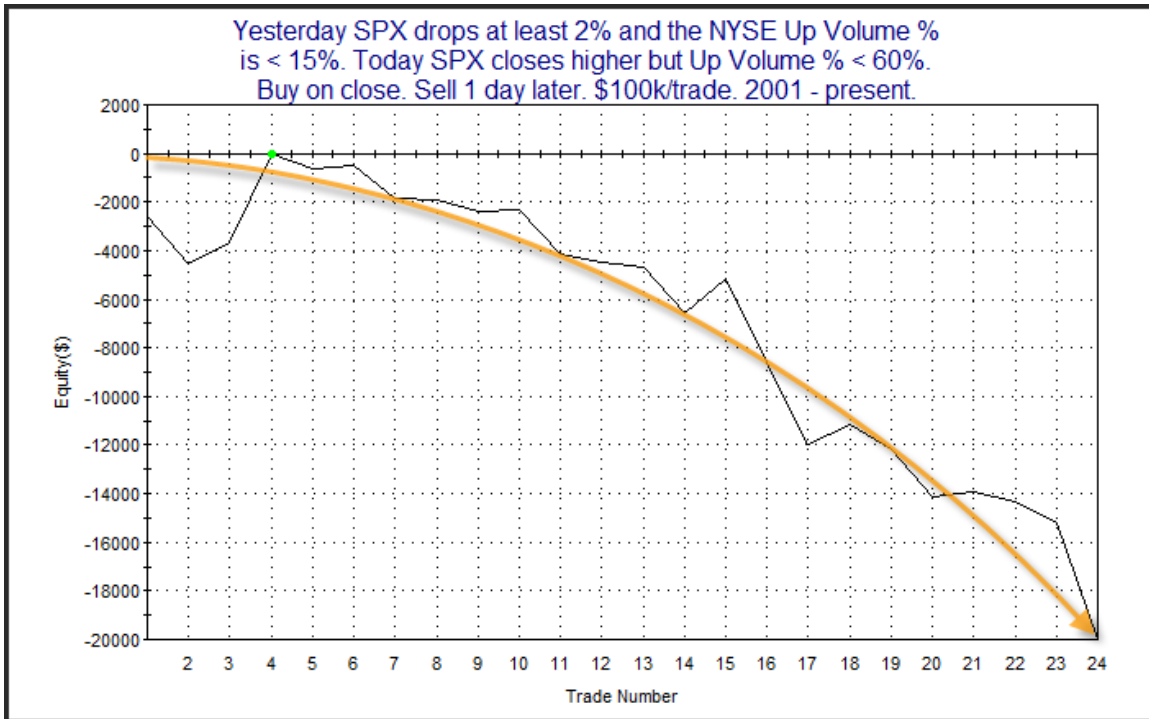
I find this equity curve appealing. One attractive aspect is the fact that the slope has been steepening.

There were also a few studies that looked at weak rebounds after big drops. The one below was last seen in the 1/26/10 blog. I have updated the results.

Yesterday SPX drops at least 2% and the NYSE Up Volume % is < 15%. Today SPX closes higher but Up Volume % < 60%. Buy 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	-18,261.91	19	6	13	31.58	4,936.21	-3,683.01	1.34	0.62	-961.15
9	-9,340.32	20	8	12	40.00	4,379.67	-3,698.14	1.18	0.79	-467.02
8	-253.88	20	8	12	40.00	5,430.39	-3,641.41	1.49	0.99	-12.69
7	-4,807.50	20	8	12	40.00	4,554.05	-3,436.66	1.33	0.88	-240.38
6	-17,902.56	20	6	14	30.00	4,296.65	-3,120.18	1.38	0.59	-895.13
5	-32,476.42	22	7	15	31.82	3,120.08	-3,621.13	0.86	0.40	-1,476.20
4	-27,988.24	22	6	16	27.27	2,965.26	-2,861.24	1.04	0.39	-1,272.19
3	-28,532.39	22	6	16	27.27	2,321.38	-2,653.79	0.87	0.33	-1,296.93
2	-24,566.92	24	9	15	37.50	1,265.54	-2,397.12	0.53	0.32	-1,023.62
1	-19,973.66	24	7	17	29.17	1,023.68	-1,596.44	0.64	0.26	-832.24

23 of 24 instances (96%) closed below the entry price at some point in the next 3 days.

The numbers from 1-5 days out all appear bearish. I did find when looking at the equity curves, though, that the 1-day holding period was by far the most consistent. I therefore decided to simply incorporate this study into the active list as a 1-day edge. Below is the 1-day equity curve.



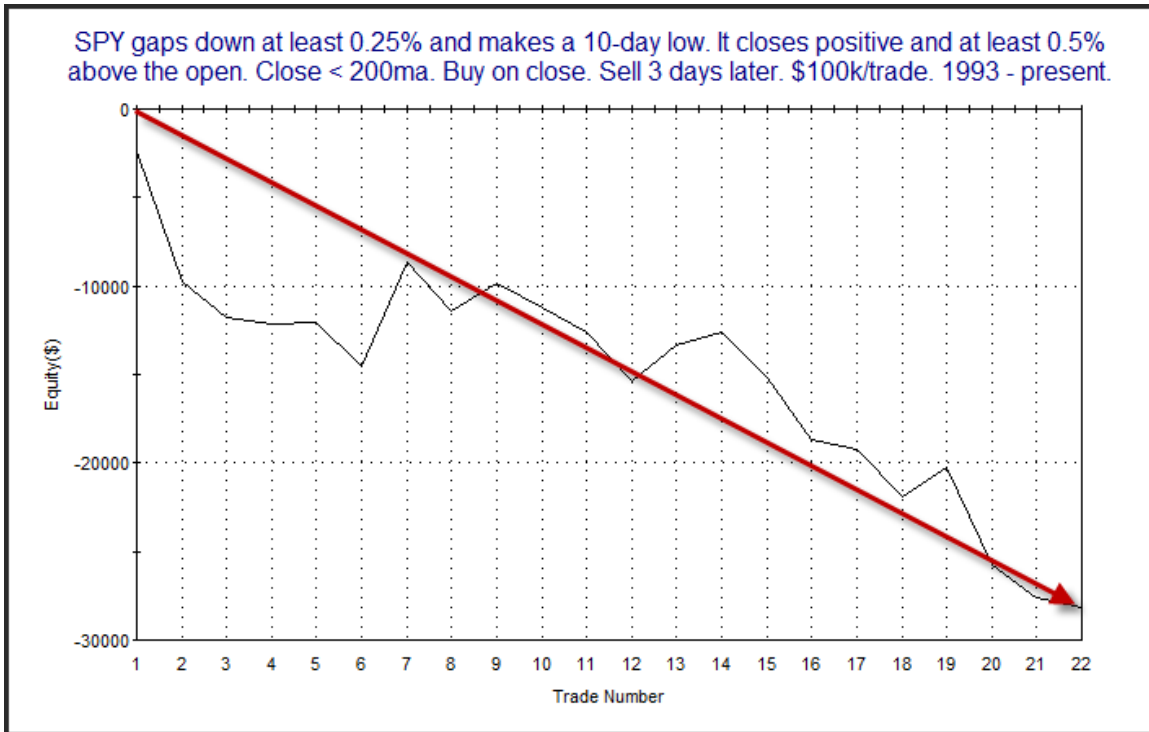
The last study I want to cover tonight was from the 8/26/10 subscriber letter. There were a couple of similar studies that looked at gap downs and reversals to a positive close. I elected to examine this one because it also incorporated the fact that the market made a 10-day intraday low. Results are all updated.

SPY gaps down at least 0.25% and makes a 10-day low. It closes positive and at least 0.5% above the open. 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	-28,564.34	17	5	12	29.41	4,442.76	-4,231.51	1.05	0.44	-1,680.26
9	-32,643.44	18	6	12	33.33	3,146.20	-4,293.39	0.73	0.37	-1,813.52
8	-34,391.39	18	6	12	33.33	3,006.66	-4,369.28	0.69	0.34	-1,910.63
7	-11,656.41	19	8	11	42.11	2,805.18	-3,099.80	0.90	0.66	-613.50
6	-18,017.15	20	9	11	45.00	2,691.84	-3,840.34	0.70	0.57	-900.86
5	-27,738.83	21	8	13	38.10	2,526.42	-3,688.47	0.68	0.42	-1,320.90
4	-25,998.08	21	7	14	33.33	2,393.83	-3,053.92	0.78	0.39	-1,238.00
3	-28,171.43	22	6	16	27.27	2,015.39	-2,516.48	0.80	0.30	-1,280.52
2	-22,448.19	24	8	16	33.33	1,678.41	-2,242.22	0.75	0.37	-935.34
1	-16,785.74	24	7	17	29.17	1,738.64	-1,703.31	1.02	0.42	-699.41

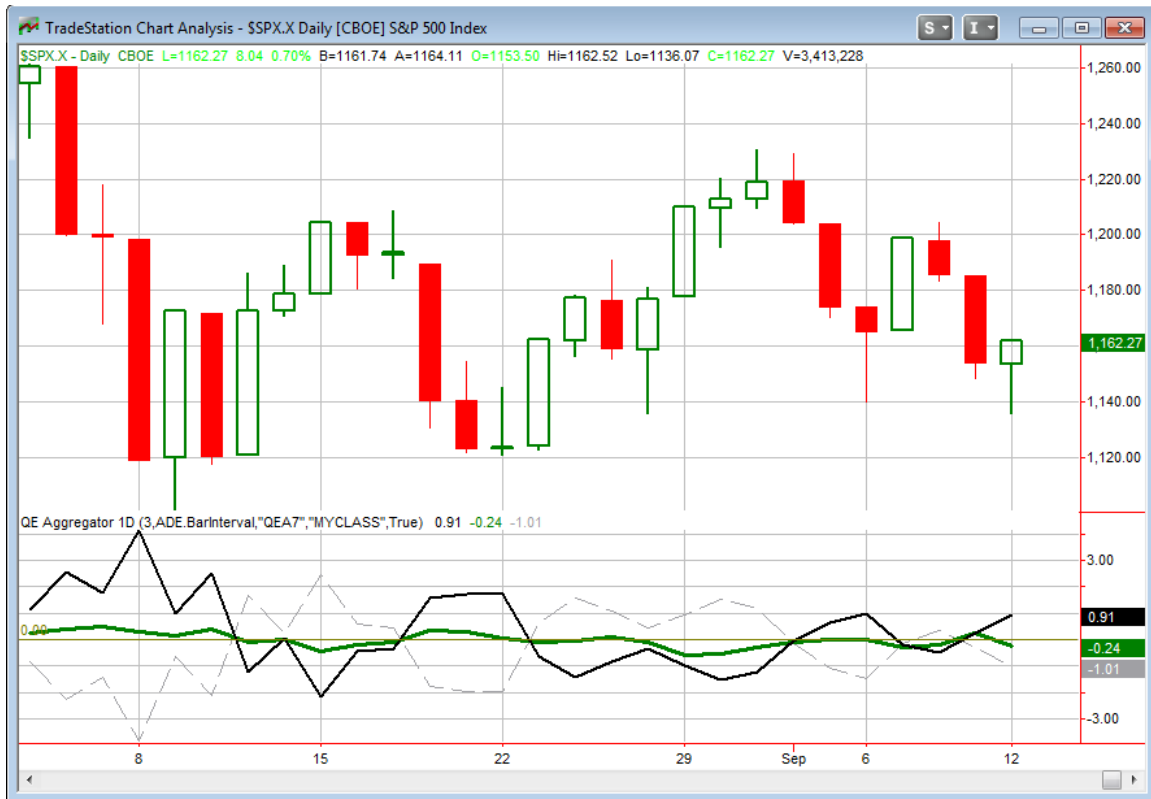
22 of 24 instances (92%) closed below the entry price at some point in the next 4 days.

Like the weak bounce study I showed earlier the consistency noted below the table is extremely strong. Below is an equity curve using a 3-day exit strategy.



This is a fairly steady equity curve, which serves to confirm the downside edge. This leaves us with 3 studies tonight worth considering – all of which suggest a bearish edge.

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



The three bearish studies tonight caused the green Aggregator line to flip back to negative. Levels below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the Differential Line stretched further 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 long to flat at the close.

The current mix of studies will keep expectations negative for the next few days. Of course this could change if bullish studies emerge. For expectations to flip on Tuesday would take some strongly bullish studies. Meanwhile, the Differential Pivot will be 1,179.81 on Tuesday. This is 1.5% above Monday's close. To turn the Differential Line negative would take a close higher of at least this much.

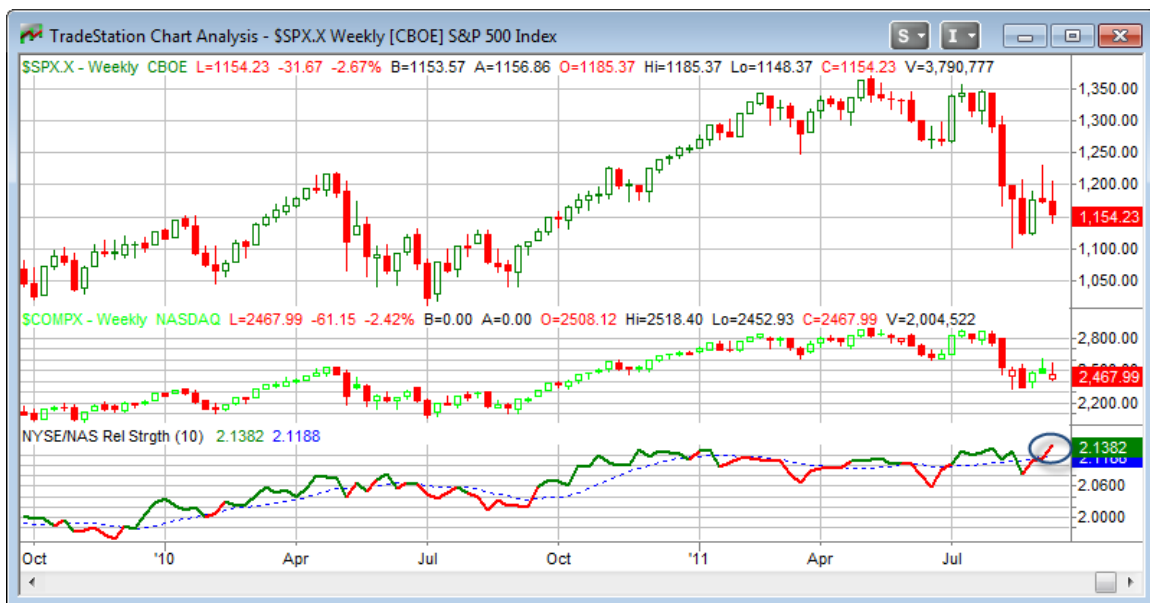
I don't see a substantial edge here. Certainly the strong bullish studies I showed over the weekend could help to push the market higher for another day or two, especially since the market remains oversold. On the other hand, evidence presented tonight strongly suggests we should see a pullback over the next few days. I did not have time to send out

an email before the close that would exit the long index trade idea. I will be looking to get flat in the morning. I will then wait for the next favorable risk/reward opportunity before taking on new exposure.

Intermediate-term Outlook (2 weeks – 2 months)– updated 9/12 – slightly bearish

The losses Thursday and Friday were steep, and likely a great disappointment to the bulls that rushed into the market between Tuesday’s open and Wednesday’s close. From a studies standpoint there wasn’t much that appeared this week with intermediate-term consequences.

One potential positive for the bulls is that the Nasdaq is now outperforming the SPX. Below is the SPX/Nasdaq Weekly Relative Strength chart from the charts page.



I’ve circled the reading at the bottom of the chart. It is now appearing in green rather than red, indicating the line color is about to change because the Nasdaq has now taken over the lead from the SPX. This is important because since near the end of 1971 (which is the 1st possible new signal after the inception of the Nasdaq) the SPX generated over 100% of its positive performance when the Nasdaq has been leading. Over that time the SPX has gained 1,268.41 points when the Nasdaq has been in the lead. Since the SPX only sits at 1,154.23 today you can easily see how important a leading Nasdaq has been over the last 40 years. More details on this indicator can be found in the blog posts below.

<http://quantifiableedges.blogspot.com/2009/05/simple-powerful-timing-indicator.html>

<http://quantifiableedges.blogspot.com/2009/06/tweaking-nasdaqs-leadlag-model.html>

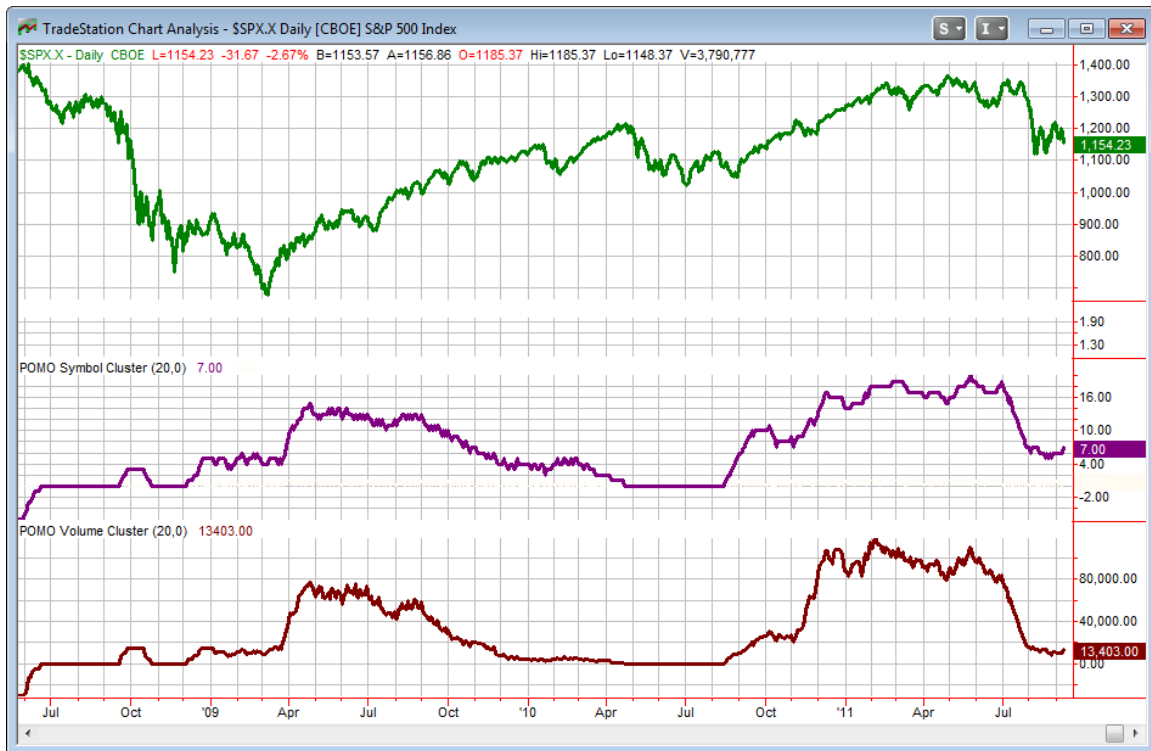
Additionally, for those subscribers that are interested in exploring this indicator more on their own, they may download the model in either Excel or Tradestation format from the downloads page of the members site at any time.

<http://www.quantifiableedges.com/members/memdownloads.php>

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 remain relatively low. After spending the last few weeks at levels quite a bit below the Fed's published schedule, purchases over the last month are extremely close to the \$14 billion number shown on the Fed's website. Stimulus still remains well below the levels that helped propel the market higher during QE1 and QE2. We keep waiting for the market to prove it can rally without substantial stimulus. So far it has not managed to do so.

While indicators remain mixed, I'm still inclined to slightly favor the short side. Bearish studies are associated with volume, liquidity (POMO), and seasonality. Bulls may find hope in the August FTD study, the breadth study from several months back, and now the leading position of the Nasdaq. Though I'm not wed to either direction I remain 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)	9/12/2011	\$114.47	\$116.67	1.92%		sell @ \$116.50

I'm placing the exit price a little below Monday's close. This is in case the SPY gaps down to start the day. I will not require the gap be completely filled before exiting. If an exit doesn't trigger in the 1st 1/2 hour or so I may send out notice placing a stop below the low of the day.

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