

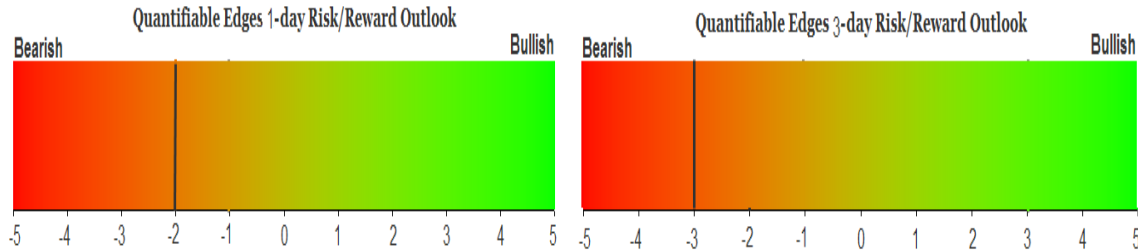
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 15, 2011

Volume 4 Issue 178

Market Overview



Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Short	75% Long VXX	100% Short SPY	Long

Tonight's Research Points

- 3 up days (with today being the strongest) below the 200ma have typically been followed by a pullback
- When SPY closes well off its higher but still up strongly on the day then there will often be a move up during the next few days.

Short-term Outlook

The Bottom Line

The Aggregator System is short and so am I. I won't be looking to increase my size on Thursday, but perhaps after that.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
September 15, 2011	3 up days. Today biggest. Close < 200	1-3 days	Bearish	-3.00%
September 15, 2011	SPY up 1% but 1% below high	1-2 days	Bullish	
September 13, 2011	SPY gap down and reverse.	1-3 days	Bearish	-3.80%
September 13, 2011	SPX up. VIX up. Monday < 200ma	1-5 days	Bearish	-3.60%
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

After a brief dip a little after 10am the market began to head higher. It was a slow grind for much of the day, but it began to accelerate after 2pm. At about 3:30 prices peaked and over the last ½ hour the SPX gave back over 1%. It still managed to close positive on the day along with the other major indices. The final result saw the SPX gain 1.3%, the Nasdaq rise 1.6% and the Russell 2000 rally 1.8%. Breadth was strong as the NYSE Up Issues % came in at 71% and the Up Volume % was 85%. Total volume lagged for almost the entire day, but it overtook Tuesday’s level in the last 2 minutes of trading.

Several studies appeared in the Quantifinder tonight. Most of them suggested a bearish inclination over the next few days. There were some common themes among many of the studies. One common theme was that 3 up days during an extended downtrend will often provide a nice short opportunity. I’ve shown this many times and many different ways in the past. The most recent discussion I had on this was in the 8/31/11 subscriber letter. One of the points I discussed there was that the edge was greatly affected by where the 3-day rally originated. Times when the market was coming off an intermediate-term low were much riskier for shorting. Often a strong bounce from a low could ignite a runaway upmove. This is much less likely to occur when the market is not emerging from an intermediate-term low. For a more detailed explanation and an example you may refer to the 8/31/11 subscriber letter. One noticeable aspect of today’s move is that it was the strongest move of the last few days. I decided to incorporate this fact along with the 3 up days and 50-day low filters and devised the study below.

<p style="text-align: center;">SPX closes up for at least the 3rd day in a row. It is not coming off a 50-day low. Today's rise is the largest of the last 3 days. Close < 200ma. Buy on close. Sell X days later. \$100k/trade. 2000 - present.</p>										
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	-8,453.34	15	7	8	46.67	1,428.10	-2,306.26	0.62	0.54	-563.56
4	-14,973.82	17	7	10	41.18	1,127.12	-2,286.37	0.49	0.35	-880.81
3	-21,932.95	18	4	14	22.22	847.82	-1,808.87	0.47	0.13	-1,218.50
2	-13,054.24	18	3	15	16.67	325.45	-935.37	0.35	0.07	-725.24
1	-10,462.52	19	4	15	21.05	1,233.41	-1,026.41	1.20	0.32	-550.66
<p>18 of 19 instances (95%) closed below the entry price at some point in the next 3 days.</p>										

The statistics seem to strongly suggest a downside edge. Below I have listed all instances assuming a 3-day holding period.

SPX closes up for at least the 3rd day in a row. It is not coming off a 50-day low. Today's rise is the largest of the last 3 days. Close < 200ma. Buy on close. Sell 3 days later. \$100k/trade. 2000 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
10/31/00	Buy	\$1,429.39	(0.19%)	\$267.72
11/03/00	Sell	\$1,426.69		(\$1,306.86)
01/11/01	Buy	\$1,326.81	0.20%	\$1,508.25
01/17/01	Sell	\$1,329.47		(\$1,141.50)
01/18/01	Buy	\$1,347.97	0.92%	\$1,104.82
01/23/01	Sell	\$1,360.40		(\$1,045.62)
05/16/01	Buy	\$1,285.00	2.17%	\$2,152.15
05/21/01	Sell	\$1,312.83		(\$296.45)
05/21/01	Buy	\$1,312.83	(1.50%)	\$235.60
05/24/01	Sell	\$1,293.13		(\$2,402.36)
06/05/01	Buy	\$1,283.56	(1.45%)	\$22.33
06/08/01	Sell	\$1,264.97		(\$1,814.89)
06/21/01	Buy	\$1,237.04	(1.64%)	\$55.20
06/26/01	Sell	\$1,216.76		(\$2,592.00)
11/06/01	Buy	\$1,118.86	0.13%	\$1,503.21
11/09/01	Sell	\$1,120.31		(\$687.97)
08/08/02	Buy	\$905.46	(2.35%)	\$933.90
08/13/02	Sell	\$884.21		(\$2,402.40)
11/06/02	Buy	\$923.76	(5.15%)	\$3.24
11/11/02	Sell	\$876.19		(\$5,302.80)
02/13/08	Buy	\$1,367.20	(1.35%)	\$70.08
02/19/08	Sell	\$1,348.78		(\$2,122.11)
04/07/08	Buy	\$1,372.53	(0.87%)	\$0.00
04/10/08	Sell	\$1,360.54		(\$1,624.32)
04/25/08	Buy	\$1,397.85	(0.88%)	\$477.12
04/30/08	Sell	\$1,385.58		(\$965.60)
08/22/08	Buy	\$1,292.18	(0.81%)	\$0.00
08/27/08	Sell	\$1,281.65		(\$2,230.69)
08/28/08	Buy	\$1,300.65	(1.97%)	\$181.64
09/03/08	Sell	\$1,274.99		(\$2,664.56)
01/02/09	Buy	\$931.80	(2.70%)	\$1,289.35
01/07/09	Sell	\$906.65		(\$3,149.01)
01/27/09	Buy	\$845.71	(2.34%)	\$3,793.70
01/30/09	Sell	\$825.88		(\$2,836.72)
04/02/09	Buy	\$834.38	(2.26%)	\$966.28
04/07/09	Sell	\$815.55		(\$2,362.15)

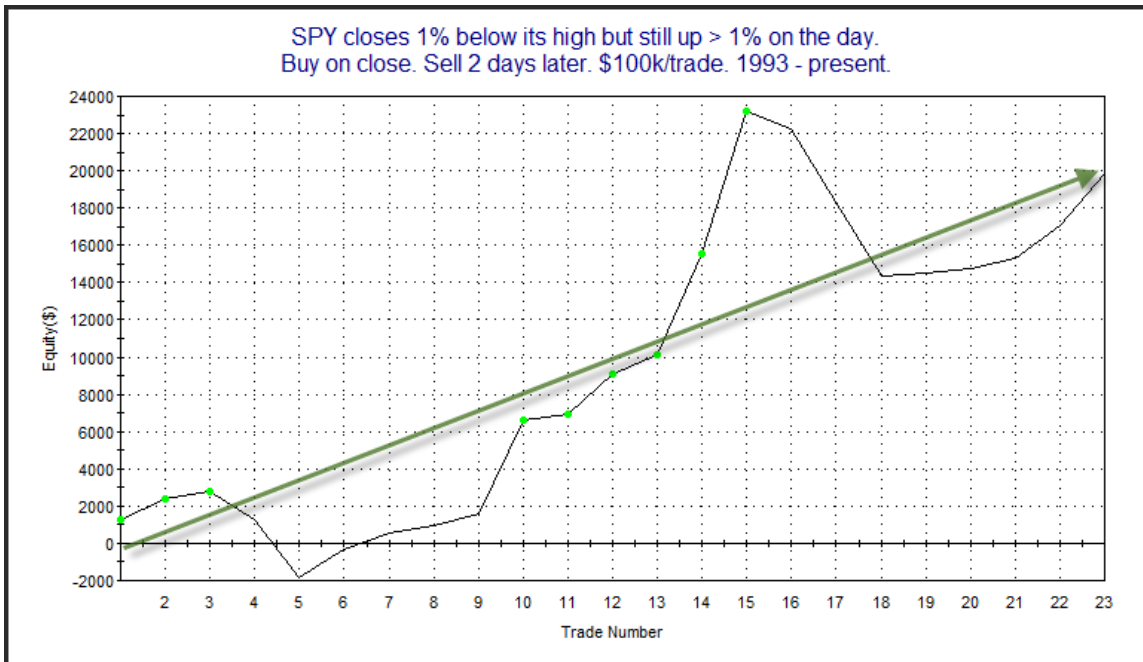
Evidence here appears even stronger than the summary table. There is quite a down-streak in place, with 10 losers in a row and 13 out of 14.

The selloff that took place in the last half hour of trading was quite notable. As we approached the close I had several studies gathered that I was going to present as

evidence tonight. None of them were bullish. But that changed in that last ½ hour. I’ve often found that sharp counter moves at the end of the day will take some of the edge off if you are looking for a short-term reversal. In other words, a strong close near the high of the day would’ve been more bearish on Wednesday than the late pullback. In fact, the size of the pullback and still-strong closing numbers suggest there may be more upside in the days ahead. In the 4/1/2009 blog I showed the study below, but using SPX instead of SPY. Tonight I am showing SPY results. All stats are updated.

SPY closes 1% below its high but still up > 1% on the day. 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	43,399.23	19	13	6	68.42	5,812.26	-5,360.03	1.08	2.35	2,284.17
9	48,638.97	19	11	8	57.89	6,289.76	-2,568.54	2.45	3.37	2,559.95
8	31,423.95	19	10	9	52.63	5,240.24	-2,330.94	2.25	2.50	1,653.89
7	28,836.89	20	13	7	65.00	4,681.81	-4,575.24	1.02	1.90	1,441.84
6	33,144.30	20	14	6	70.00	3,989.40	-3,784.54	1.05	2.46	1,657.22
5	23,566.90	21	13	8	61.90	3,223.19	-2,291.81	1.41	2.29	1,122.23
4	23,456.08	22	13	9	59.09	3,522.22	-2,481.42	1.42	2.05	1,066.19
3	18,642.09	23	13	10	56.52	3,234.39	-2,340.50	1.38	1.80	810.53
2	19,885.74	23	18	5	78.26	1,856.59	-2,706.57	0.69	2.47	864.60
1	10,296.85	26	18	8	69.23	1,334.80	-1,716.19	0.78	1.75	396.03

Odds here appear to favor a move higher. Below is an equity curve using a 2-day holding period.



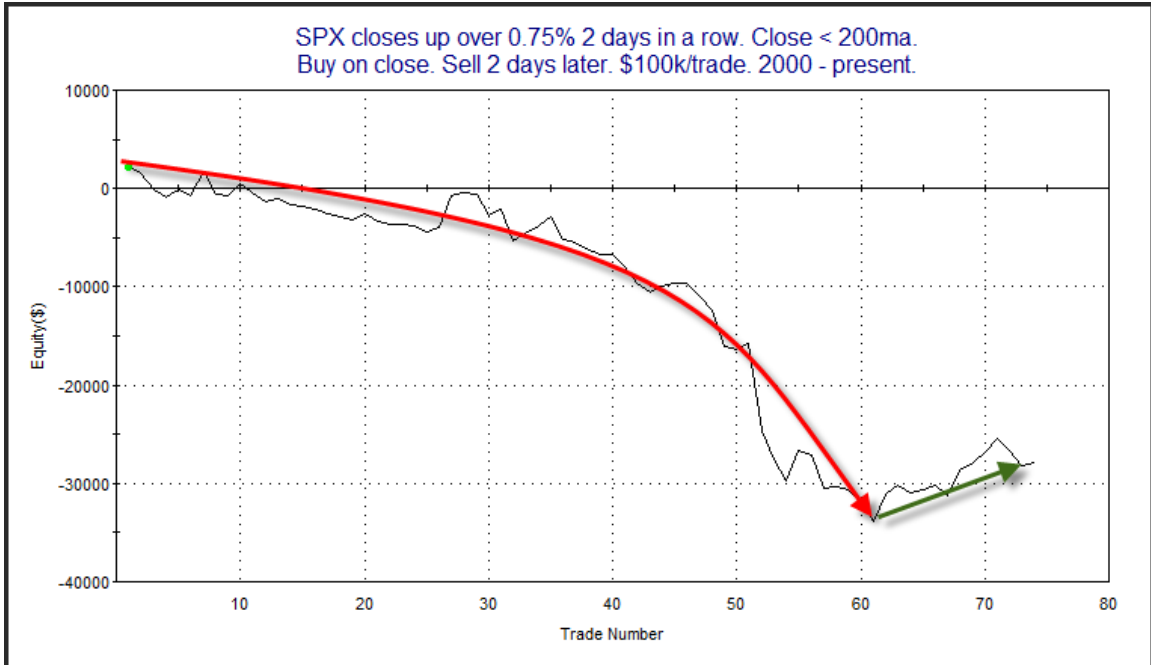
This curve is a bit choppy than I would prefer. Still, I think this study appears worthy of consideration.

There were also a few studies listed in the Quantifinder whose edges don't appear to be as prolific as they once were. The example below is from the 9/3/10 subscriber letter.

SPX closes up over 0.75% 2 days in a row. Close < 200ma.
Buy on close. Sell X days later. \$100k/trade. 2000 - present.

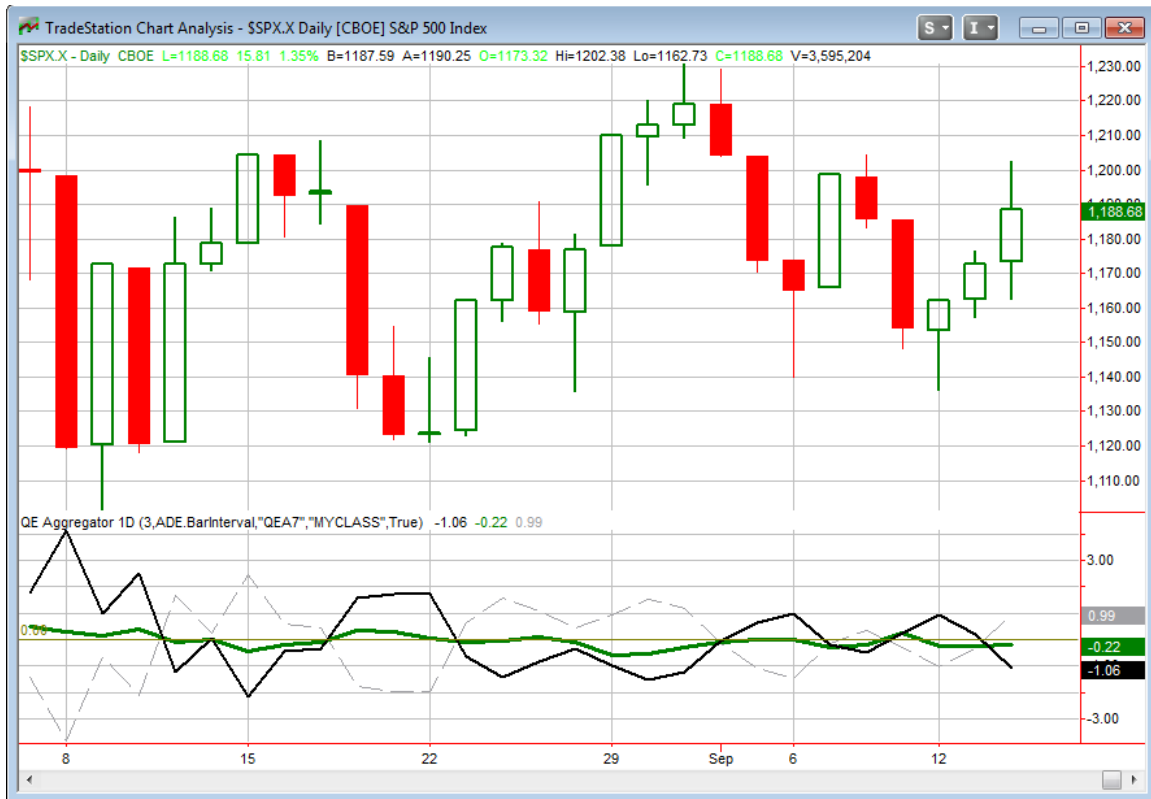
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	-32,173.66	44	21	23	47.73	2,927.97	-4,072.22	0.72	0.66	-731.22
9	-25,081.77	49	22	27	44.90	2,921.45	-3,309.40	0.88	0.72	-511.87
8	-21,296.03	50	23	27	46.00	2,778.43	-3,155.56	0.88	0.75	-425.92
7	-34,385.32	52	21	31	40.38	3,010.11	-3,148.31	0.96	0.65	-661.26
6	-10,407.48	56	27	29	48.21	2,910.85	-3,068.98	0.95	0.88	-185.85
5	-18,900.95	57	28	29	49.12	2,184.33	-2,760.77	0.79	0.76	-331.60
4	-45,348.28	59	27	32	45.76	1,539.14	-2,715.78	0.57	0.48	-768.61
3	-16,318.39	64	30	34	46.88	1,853.82	-2,115.68	0.88	0.77	-254.97
2	-24,759.07	66	31	35	46.97	1,535.39	-2,067.32	0.74	0.66	-375.14
1	-27,937.84	74	29	45	39.19	1,038.33	-1,289.99	0.80	0.52	-377.54

The numbers here appear bearish. But let's take a look at the equity curve.



As you can see, recent instances have not been followed by the typical move lower. It's too soon to tell whether this is a change in character for the market or just an anomaly. For now I will continue to monitor this study but will not be including it on the active list.

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



Despite the new studies being added to the mix, the green Aggregator line barely budged again today. It remains negative. Levels below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the Differential Line fell again and is now 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. Historically this combination has suggested a bearish edge. Bearish configurations can be seen on the chart whenever both lines close below 0. Due to this the Aggregator System changed from flat to short at the close.

Based on the current active studies the green Aggregator line is poised to close below 0 again on Thursday. Of course this could change if bullish studies emerge. Meanwhile, the Differential Pivot will be 1,159.96 on Thursday. This is 2.4% below Wednesday's close. A drop this large is possible, but unlikely. A more likely scenario is a multi-day move lower.

The bottom line is that I feel the market has a very good chance to pull back over the next few days. But it may have a little bounce in it first. The trade idea from last night filled short at the close. If I had not entered at the close I would probably be looking to enter at a level near Wednesday's high rather than Wednesday's close. I'm not going to quickly

increase my exposure yet. I will give it a day, and if the downside pressure persists I may look to increase my size on Friday.

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>

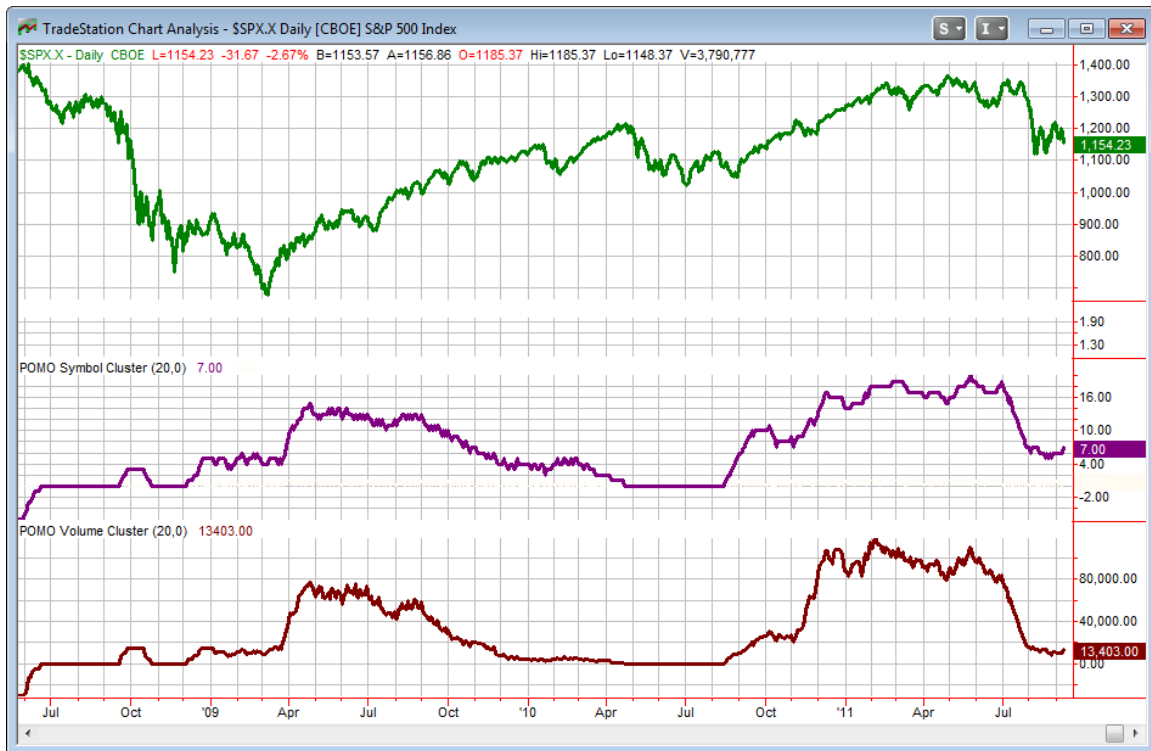
Additionally, for those subscribers that are interested in exploring this indicator more on their own, they may download the model in either Excel or Tradestation format from the downloads page of the members site at any time.

<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)(s)	9/14/2011	\$119.37	\$119.37	0.00%		shorted on close

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