

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 20, 2011

Volume 4 Issue 181

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- Low volume drops from an overbought reading during a long-term downtrend will often offer good short opportunities.
- When SPY posts a large gap down and then partially fills the gap on a positive open-close rally but still finishes down on the day, then that has typically led to a bounce higher over the next few days.
- Wednesday is a Fed Day.

## *Short-term Outlook*

### *The Bottom Line*

The bearish edge remains, but if it plays out on Tuesday then the edge will likely flip to the long side. If this happens, I will close out my short and look to take on a small long position.

*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 20, 2011	Low volume drop from overbought	1-2 days	Bearish	
September 20, 2011	Gap down and partial fill	1-3 days	Bullish	3.80%
September 19, 2011	Overbought post Sept opex	1-4 days	Bearish	-2.40%
<b>Active - Long Term</b>				
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	
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 16, 2011	3 70% Up Issue Days	1-2 days	Bullish	2.20%
September 15, 2011	3 up days. Today biggest. Close < 200	1-3 days	Bearish	-3.00%
September 13, 2011	SPX up. VIX up. Monday < 200ma	1-5 days	Bearish	-3.60%
<b>September 19, 2011</b>	<b>Overbought low range, under 200</b>	<b>1-2 days</b>	<b>Bearish</b>	<b>-1.70%</b>
September 19, 2011	Overbought post Sept opex	1-4 days	Bearish	-2.40%
September 19, 2011	Overbought post Sept opex	1-4 days	Bearish	-2.40%
<b>September 16, 2011</b>	<b>3/10 HV &lt; 0.25. RSI(2) &gt; 90.</b>	<b>1-2 days</b>	<b>Bearish</b>	<b>-2.40%</b>
August 16, 2011	SPY up 3. Vol down 3 days.	1-20 days	Bearish	

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

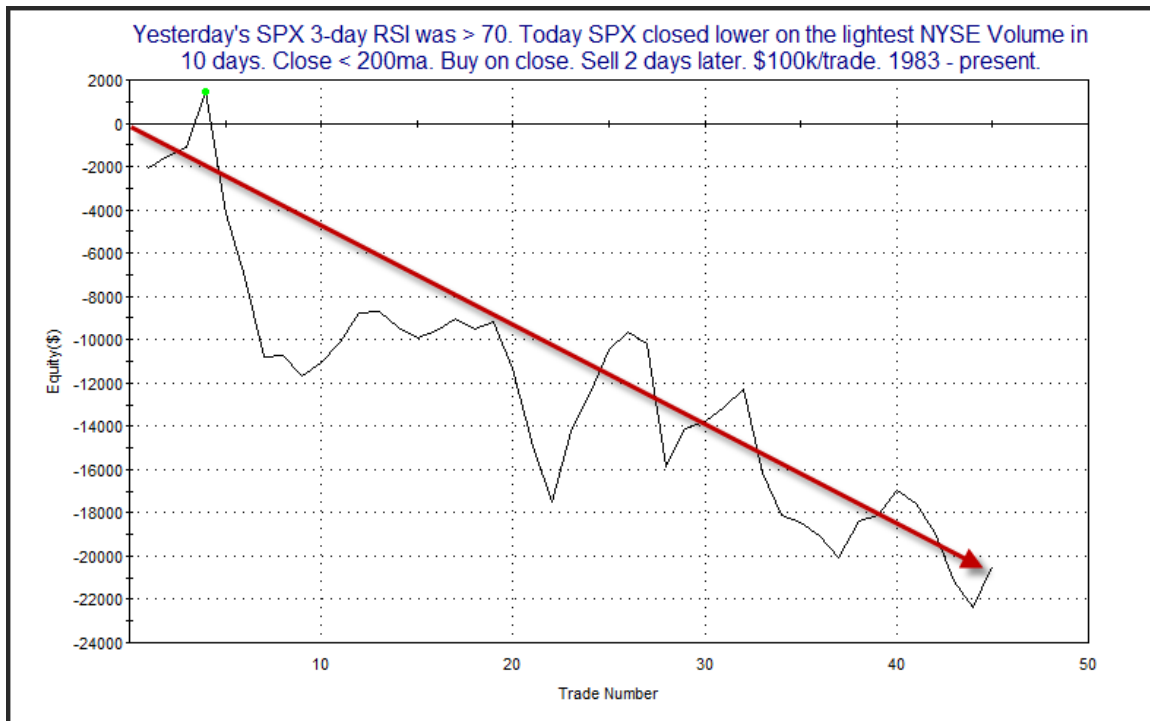
**The Evidence**

The markets all closed lower on Monday, but they were well off their lows after a difficult early morning. Even so, the SPX lost 1.0%, the NASDAQ was down 0.4%, and the Russell 2000 fell 1.7%. Breadth was also very weak as the NYSE Up Issues % came in at 22% and the Up Volume % was 13%. Total NYSE volume dropped considerably, and came in at the lowest level in several weeks.

In the 9/22/09 Subscriber Letter I showed a study that suggested that very-low volume pullbacks from overbought conditions during long-term downtrends have a tendency to pull back for more than one day. I have updated the study below.

Yesterday's SPX 3-day RSI was > 70. Today SPX closed lower on the lightest NYSE Volume in 10 days. Close < 200ma. Buy on close. Sell X days later. \$100k/trade. 1983 - 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	-9,907.15	43	20	23	46.51	2,375.89	-2,496.74	0.95	0.83	-230.40
4	-11,876.30	44	19	25	43.18	2,124.11	-2,089.37	1.02	0.77	-269.92
3	-16,613.23	44	20	24	45.45	1,666.27	-2,080.78	0.80	0.67	-377.57
2	-20,502.15	45	23	22	51.11	1,054.34	-2,034.19	0.52	0.54	-455.60
1	-14,606.68	46	21	25	45.65	813.65	-1,267.74	0.64	0.54	-317.54

Based on the statistics table there appears to be a bit of a downside edge over the first 1-2 days. To see how this apparent edge has played out over time I have produced the equity curve below.



While there are several gyrations both above and below the line, this setup appears to have consistently been followed by selling. The study certainly appears worthy of inclusion on the active list.

There were a couple of studies from the 6/24/11 subscriber letter that examined SPY action and indicated bullish inclinations. The primary theme of the studies is that SPY endured a large gap lower and only managed to make back part of the gap by the end of the day. Results for both of the studies have been updated.

SPY gaps down at least 1%. It closes down on the day but at least 0.5% above the open. Close > 10ma. Buy on close. Sell X days later. \$100k/trade. 9/1/98 - 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	14,883.96	9	6	3	66.67	4,228.95	-3,496.57	1.21	2.42	1,653.77
9	10,072.05	9	6	3	66.67	4,047.82	-4,738.29	0.85	1.71	1,119.12
8	18,789.80	10	7	3	70.00	4,243.52	-3,638.29	1.17	2.72	1,878.98
7	16,683.14	10	7	3	70.00	3,665.18	-2,991.05	1.23	2.86	1,668.31
6	18,893.15	10	7	3	70.00	3,716.46	-2,374.02	1.57	3.65	1,889.32
5	16,580.60	10	7	3	70.00	3,413.28	-2,437.46	1.40	3.27	1,658.06
4	11,002.86	10	8	2	80.00	2,476.35	-4,403.98	0.56	2.25	1,100.29
3	13,005.69	10	8	2	80.00	2,085.28	-1,838.29	1.13	4.54	1,300.57
2	11,004.01	10	8	2	80.00	1,572.52	-788.08	2.00	7.98	1,100.40
1	6,562.92	10	7	3	70.00	1,452.29	-1,201.03	1.21	2.82	656.29

All 10 instances closed above the entry price at some point in the next 3 days.

The number of studies is quite low, but there is clearly a bullish bias. Below I have listed all incidents. A 3-day holding period is assumed.

SPY gaps down at least 1%. It closes down on the day but at least 0.5% above the open. Close > 10ma. Buy on close. Sell X days later. \$100k/trade. 9/1/98 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
09/25/98	Buy	\$104.25	(2.40%)	\$1,975.54
09/30/98	Sell	\$101.75		(\$2,752.33)
04/27/00	Buy	\$146.00	(1.28%)	\$1,696.32
05/02/00	Sell	\$144.13		(\$1,279.08)
11/12/01	Buy	\$112.03	2.54%	\$3,006.04
11/15/01	Sell	\$114.87		\$0.00
08/12/02	Buy	\$90.62	3.18%	\$3,717.11
08/15/02	Sell	\$93.50		(\$2,867.80)
10/22/02	Buy	\$89.52	0.76%	\$1,541.46
10/25/02	Sell	\$90.20		(\$2,055.28)
04/28/09	Buy	\$85.57	2.71%	\$4,029.60
05/01/09	Sell	\$87.89		\$0.00
02/12/10	Buy	\$108.04	2.66%	\$2,867.50
02/18/10	Sell	\$110.91		\$0.00
02/25/10	Buy	\$110.67	1.38%	\$1,869.21
03/02/10	Sell	\$112.20		(\$505.68)
07/30/10	Buy	\$110.27	2.45%	\$2,573.04
08/04/10	Sell	\$112.97		\$0.00
06/23/11	Buy	\$128.30	1.02%	\$1,036.07
06/28/11	Sell	\$129.61		(\$1,308.72)

The last eight instances all closed higher, and they all ran up over 1% from the entry point during the period. The study only requires a close below yesterday's close. It doesn't require the gap up never get filled during the day. This next study, also from 6/24/11, does require the gap down to go unfilled during the day.

SPY gaps down at least 1%. It never fills and closes at least 0.5% above the open. Close > 10ma. 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	23,162.23	6	6	0	100.00	3,860.37	0.00	100.00	100.00	3,860.37
9	21,050.60	6	6	0	100.00	3,508.43	0.00	100.00	100.00	3,508.43
8	22,898.78	7	7	0	100.00	3,271.25	0.00	100.00	100.00	3,271.25
7	17,792.65	7	6	1	85.71	3,151.61	-1,117.00	2.82	16.93	2,541.81
6	17,754.59	7	6	1	85.71	2,975.85	-100.53	29.60	177.61	2,536.37
5	15,200.11	7	6	1	85.71	2,710.21	-1,061.15	2.55	15.32	2,171.44
4	10,196.26	7	6	1	85.71	1,878.54	-1,075.00	1.75	10.48	1,456.61
3	8,903.31	7	6	1	85.71	1,921.05	-2,623.00	0.73	4.39	1,271.90
2	5,120.01	7	4	3	57.14	1,816.48	-715.30	2.54	3.39	731.43
1	1,060.45	7	4	3	57.14	1,160.78	-1,194.22	0.97	1.30	151.49

Here again we see a very low number of instances but a clear upside tendency in those instances. Below are the 7 instances and their 8-day returns.

SPY gaps down > 1%. It never fills and closes at least 0.5% above the open. Close > 10ma. Buy on close. Sell 8 days later. \$100k/trade. 1993 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
11/07/97	Buy	\$92.94	1.85%	\$2,547.75
11/19/97	Sell	\$94.66		(\$3,063.75)
11/12/01	Buy	\$112.03	3.26%	\$3,407.44
11/23/01	Sell	\$115.68		\$0.00
08/12/02	Buy	\$90.62	6.69%	\$7,202.59
08/22/02	Sell	\$96.68		(\$2,867.80)
10/22/02	Buy	\$89.52	0.84%	\$1,977.09
11/01/02	Sell	\$90.27		(\$2,814.84)
02/12/10	Buy	\$108.04	2.43%	\$3,274.50
02/25/10	Sell	\$110.67		\$0.00
02/25/10	Buy	\$110.67	3.42%	\$3,900.96
03/09/10	Sell	\$114.46		(\$505.68)
06/23/11	Buy	\$128.30	4.42%	\$4,549.36
07/06/11	Sell	\$133.97		(\$1,308.72)

Not only are all the instances positive, but the risks far outweigh the rewards when looking at the runup/drawdown statistics. The average run-up was about 3.8%, while the average drawdown was -1.5%, and the max drawdown was under -3.1%.

Lastly, I should note that Wednesday is a Fed Day. I received a question from a reader today who wondered how Fed Days have fared during the week following September op-ex. As I've discussed in the past, Fed Days have had a strong bullish tendency over the years, but as I mentioned last night, this has historically been the most bearish week of the year. Below I have listed all Fed Days that have fallen during this week in September.

Fed Days during the week after September op-ex. 1982 - present. \$100k/trade.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
09/22/86	Buy	\$234.92	0.32%	\$408.00
09/23/86	Sell	\$235.66		(\$178.50)
09/21/87	Buy	\$310.54	2.89%	\$2,888.34
09/22/87	Sell	\$319.50		(\$598.92)
09/19/88	Buy	\$268.82	0.33%	\$463.75
09/20/88	Sell	\$269.72		(\$118.72)
09/20/93	Buy	\$455.05	(0.46%)	\$164.25
09/21/93	Sell	\$452.94		(\$1,186.98)
09/23/96	Buy	\$686.48	(0.13%)	\$638.00
09/24/96	Sell	\$685.61		(\$426.30)
09/23/02	Buy	\$833.70	(1.73%)	\$8.33
09/24/02	Sell	\$819.29		(\$1,909.95)
09/20/04	Buy	\$1,122.20	0.63%	\$831.26
09/21/04	Sell	\$1,129.30		\$0.00
09/19/05	Buy	\$1,231.02	(0.79%)	\$443.07
09/20/05	Sell	\$1,221.34		(\$886.95)
09/19/06	Buy	\$1,318.31	0.52%	\$766.50
09/20/06	Sell	\$1,325.18		(\$2.25)
09/22/09	Buy	\$1,071.66	(1.01%)	\$789.57
09/23/09	Sell	\$1,060.87		(\$1,048.11)
09/20/10	Buy	\$1,142.71	(0.26%)	\$511.56
09/21/10	Sell	\$1,139.78		(\$564.63)

There have only been 11 instances, and I don't see a substantial edge in either direction. Results are lower than with a typical Fed Day, but not so much that it will change my approach. So rather than worrying about the week, I will apply some of the other filters I've used before for Fed Day edges. My primary concern considering a possible Fed Day edge is noting where SPY closes in relation to its intraday range.

So we are looking at a mix of studies being added to the Active List tonight.

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



Today's studies caused the green Aggregator line to inch closer to positive territory. Levels below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the Differential Line remains 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 remained short at the close.

Based on the current active studies the green Aggregator line is poised to rally back above 0 on Tuesday. Of course this could change depending on market action. Meanwhile, the Differential Pivot will be 1,203.25. This is less than 0.1% below

Monday's close. In other words, it won't take much of a selloff to move from overbought to oversold.

I have a mid-sized short position. Expectations are still negative and the market is still overbought, but both of those conditions could easily flip tomorrow. For now it appears that a down close would likely change the short trigger to a long trigger on Tuesday. With Wednesday being a Fed Day, and a chunk of the Fed Day bullish edge actually occurring in the overnight, I will be looking to cover my short on a down close, and may even take on some long exposure. Details in the Trade Ideas section below.

**Intermediate-term Outlook (2 weeks – 2 months)– updated 9/19 – slightly bearish**

The move higher this week was impressive. It did manage to (re)trigger one study with intermediate-term bullish consequences. Tuesday, Wednesday, and Thursday all closed strongly higher and the NYSE Up Issues % exceeded 70% each of those days. The study below is one that I last showed in the 3/21/11 subscriber letter and it has been active since then. Results are now updated to include the March instance as well.

NYSE Up Issues % > 70% for exactly the 3rd day in a row. Buy SPX on close. Sell X days later. \$100k/trade. 1967 - 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
200	189,454.67	11	9	2	81.82	21,290.18	-1,078.45	19.74	88.84	17,223.15
190	202,941.78	11	11	0	100.00	18,449.25	0.00	100.00	100.00	18,449.25
180	211,208.63	11	11	0	100.00	19,200.78	0.00	100.00	100.00	19,200.78
170	193,444.27	12	12	0	100.00	16,120.36	0.00	100.00	100.00	16,120.36
160	190,654.63	12	12	0	100.00	15,887.89	0.00	100.00	100.00	15,887.89
150	189,374.17	12	12	0	100.00	15,781.18	0.00	100.00	100.00	15,781.18
140	174,839.16	12	12	0	100.00	14,569.93	0.00	100.00	100.00	14,569.93
130	155,443.51	13	12	1	92.31	13,423.27	-5,635.69	2.38	28.58	11,957.19
120	113,065.79	14	11	3	78.57	11,457.94	-4,323.86	2.65	9.72	8,076.13
110	103,997.85	14	13	1	92.86	8,823.79	-10,711.47	0.82	10.71	7,428.42
100	99,235.46	14	11	3	78.57	10,146.31	-4,124.64	2.46	9.02	7,088.25
90	112,768.01	14	12	2	85.71	9,908.26	-3,065.58	3.23	19.39	8,054.86
80	107,007.12	14	13	1	92.86	8,710.02	-6,223.12	1.40	18.20	7,643.37
70	81,378.73	14	13	1	92.86	6,916.22	-8,532.18	0.81	10.54	5,812.77
60	79,636.48	15	12	3	80.00	8,170.87	-6,137.98	1.33	5.32	5,309.10
50	82,845.62	16	13	3	81.25	8,232.64	-8,059.59	1.02	4.43	5,177.85
40	59,218.37	16	13	3	81.25	7,175.85	-11,355.88	0.63	2.74	3,701.15
30	51,386.67	17	12	5	70.59	6,129.03	-4,432.34	1.38	3.32	3,022.75
20	55,813.17	17	14	3	82.35	5,110.66	-5,245.36	0.97	4.55	3,283.13
10	29,308.43	18	14	4	77.78	3,219.27	-3,940.32	0.82	2.86	1,628.25

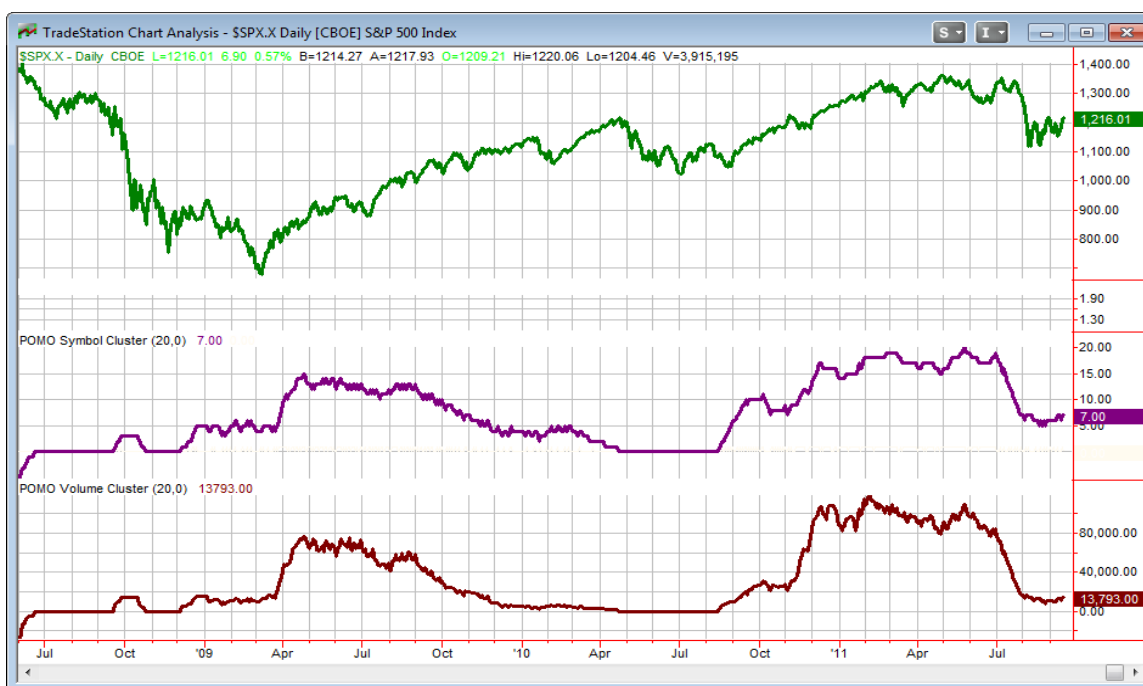
**We are currently between 120 and 130 days from the 3/21/11 instance when the SPX closed at 1,298.38.**

While the March instance is still “active” this repeat occurrence on Thursday may be seen as a positive sign.

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 barely budged and remain relatively low. The purchase amounts over the last month are extremely close to the \$14billion 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 that retriggered this week, and the leading position of the Nasdaq. At this point 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.

***SPY – buy ¼ index position ON CLOSE if SPX closes <= 1,203.25 AND SPY closes in the lower ½ of its daily range.*** Based on short-term outlook above. When the day before a Fed Day closes poorly it tends to improve the odds and the reward/risk ratio for the Fed Day. With the Aggregator already poised to flip positive, inclusion of a potent Fed Day study would likely confirm the flip. I'm hoping to flip from short to long under this scenario.

### **Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	9/14/2011	\$119.37	\$120.93	-1.31%		current price div adjusted
SPY(1/4)(s)	9/16/2011	\$121.43	\$120.31	0.92%		Aggregator

*Cover both lots of SPY on an SPX close <= 1,203.25.*

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