

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 22, 2011

Volume 4 Issue 183

## Market Overview



## Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Long	100% Long XIV	100% Long XIV	Long

## Tonight's Research Points

- Most of what I looked at was rather docile considering the sizable selloff on Wednesday.
- Fed Days that close down and well off their highs typically bounce in the next few days.

## *Short-term Outlook*

### *The Bottom Line*

The Aggregator suggests an upside edge, but the evidence is underwhelming. I'm partially long and no looking to increase the size just yet. The one trade idea I am considering is the lone Catapult, which has bumped the CBI from 0 to 1.

*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 22, 2011	2% below high and down on Fed Day	1-3 days	Bullish	3.00%
September 21, 2011	1% up 10-high then close down	1-7 days	Bullish	3.25%
September 20, 2011	Gap down and partial fill	1-3 days	Bullish	3.80%
<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 21, 2011	Bottom 25% daily range b4 Fed Day	1 day	Bullish	
<b>September 20, 2011</b>	<b>Low volume drop from overbought</b>	<b>1-2 days</b>	<b>Bearish</b>	
<b>September 19, 2011</b>	<b>Overbought post Sept opex</b>	<b>1-4 days</b>	<b>Bearish</b>	<b>-2.40%</b>

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

**The Evidence**

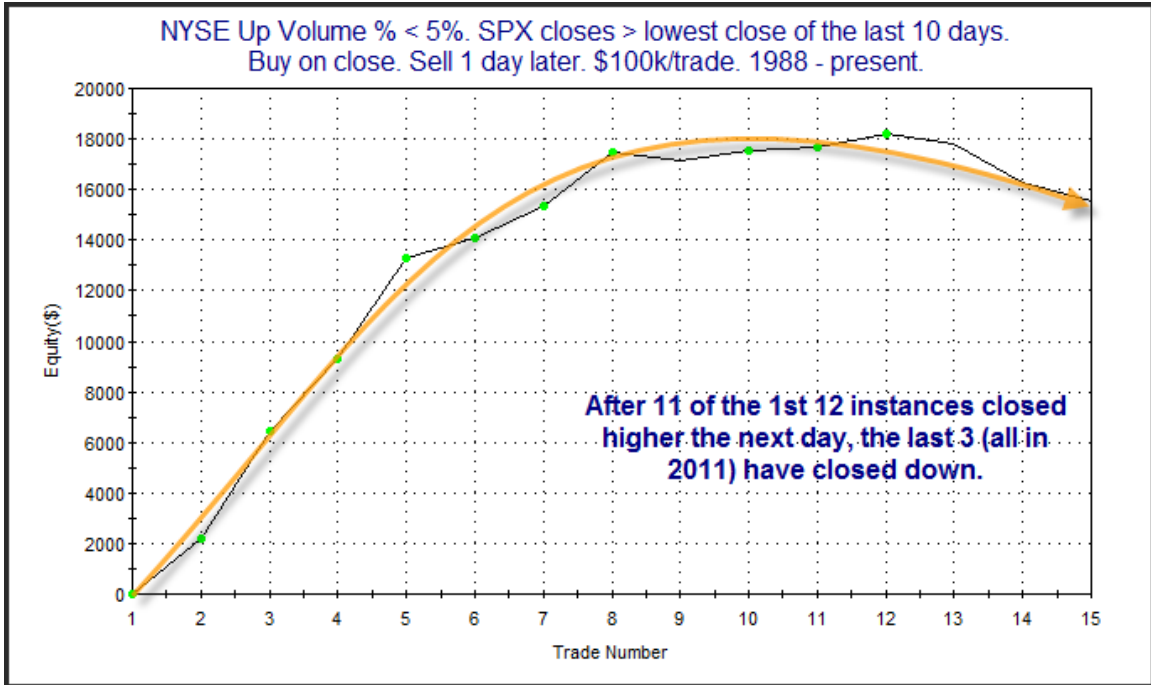
Fed Days are typically bullish, but this one got steamrolled. It was the worst performance for the SPX on a Fed Day since at least 1982, which is as far back as I track Fed Days. The next worse day was 12/11/07, when the SPX lost 2.5%. Wednesday it lost 2.9% while the Nasdaq fell 2.0% and the Russell 2000 declined 3.7%. Breadth was extremely negative as the NYSE Up Issues % came in at 16% and the Up Volume % was just 4%. Total volume hit the highest level of the last 3 days.

The selling was extreme on Wednesday, but surprisingly few studies triggered that were strongly compelling. And some of those that once appeared very strong no longer appeared so persuasive. One example of that can be found in the stats table below.

NYSE Up Volume % < 5%. SPX closes > lowest close of the last 10 days. Buy on close. Sell X days later. \$100k/trade. 1988 - 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	20,486.98	15	9	6	60.00	3,767.37	-2,236.56	1.68	2.53	1,365.80
4	17,507.93	15	9	6	60.00	4,090.39	-3,217.60	1.27	1.91	1,167.20
3	25,971.11	15	10	5	66.67	2,998.03	-801.84	3.74	7.48	1,731.41
2	21,648.69	15	11	4	73.33	2,251.48	-779.40	2.89	7.94	1,443.25
1	15,563.60	15	11	4	73.33	1,687.53	-749.81	2.25	6.19	1,037.57

I last looked at this study in the 9/6/11 subscriber letter. I decided not to include on the active list that day and again today. The equity curves across the 1-3 period where there

appears to be a substantial edge in the table above has lost much of its appeal. To illustrate, below is the 1-day curve.



All the gains were made in the 1<sup>st</sup> half of the instances here. It will be a while before I include this study on the active list again.

One study that showed some promise looked at Fed Days that closed down and at least 1% off their intraday highs. The drop today was much more intense, so I upped the requirement to a 2% drop from the intraday high. Results of doing this are below.

Today is a Fed Day. SPY closes down on the day and at least 2% below its high.  
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	19,679.92	11	8	3	72.73	3,132.40	-1,793.10	1.75	4.66	1,789.08
4	22,465.23	11	8	3	72.73	3,350.83	-1,447.15	2.32	6.17	2,042.29
3	20,097.23	11	9	2	81.82	2,414.01	-814.42	2.96	13.34	1,827.02
2	15,520.12	11	9	2	81.82	2,271.69	-2,462.55	0.92	4.15	1,410.92
1	9,767.48	11	9	2	81.82	1,596.87	-2,302.16	0.69	3.12	887.95

All 11 instances posted a close above the entry price within 3 days.

The results here suggest a bullish edge – especially over the 1<sup>st</sup> 3 days. Below I have listed all instances assuming a 3-day holding period.

Today is a Fed Day. SPY closes down on the day and at least 2% below its high. Buy on close. Sell 3 days later. \$100k/trade. 1993 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
02/04/94	Buy	\$46.98	0.94%	\$978.88
02/09/94	Sell	\$47.42		(\$297.92)
02/05/97	Buy	\$77.64	1.15%	\$2,934.36
02/10/97	Sell	\$78.53		(\$296.01)
11/12/97	Buy	\$90.50	4.73%	\$5,310.24
11/17/97	Sell	\$94.78		(\$452.64)
10/03/00	Buy	\$142.63	(1.13%)	\$1,549.21
10/06/00	Sell	\$141.02		(\$2,018.88)
12/19/00	Buy	\$130.03	0.70%	\$815.14
12/22/00	Sell	\$130.94		(\$3,460.50)
03/20/01	Buy	\$114.20	0.25%	\$927.50
03/23/01	Sell	\$114.48		(\$5,390.00)
08/21/01	Buy	\$115.82	2.76%	\$2,856.53
08/24/01	Sell	\$119.02		(\$34.52)
08/13/02	Buy	\$88.97	4.78%	\$5,738.53
08/16/02	Sell	\$93.22		(\$1,066.85)
12/11/07	Buy	\$147.91	(0.50%)	\$2,609.36
12/14/07	Sell	\$147.17		(\$547.56)
01/30/08	Buy	\$134.91	2.11%	\$3,482.70
02/04/08	Sell	\$137.76		(\$1,267.11)
10/29/08	Buy	\$93.08	4.33%	\$5,896.26
11/03/08	Sell	\$97.11		(\$193.32)

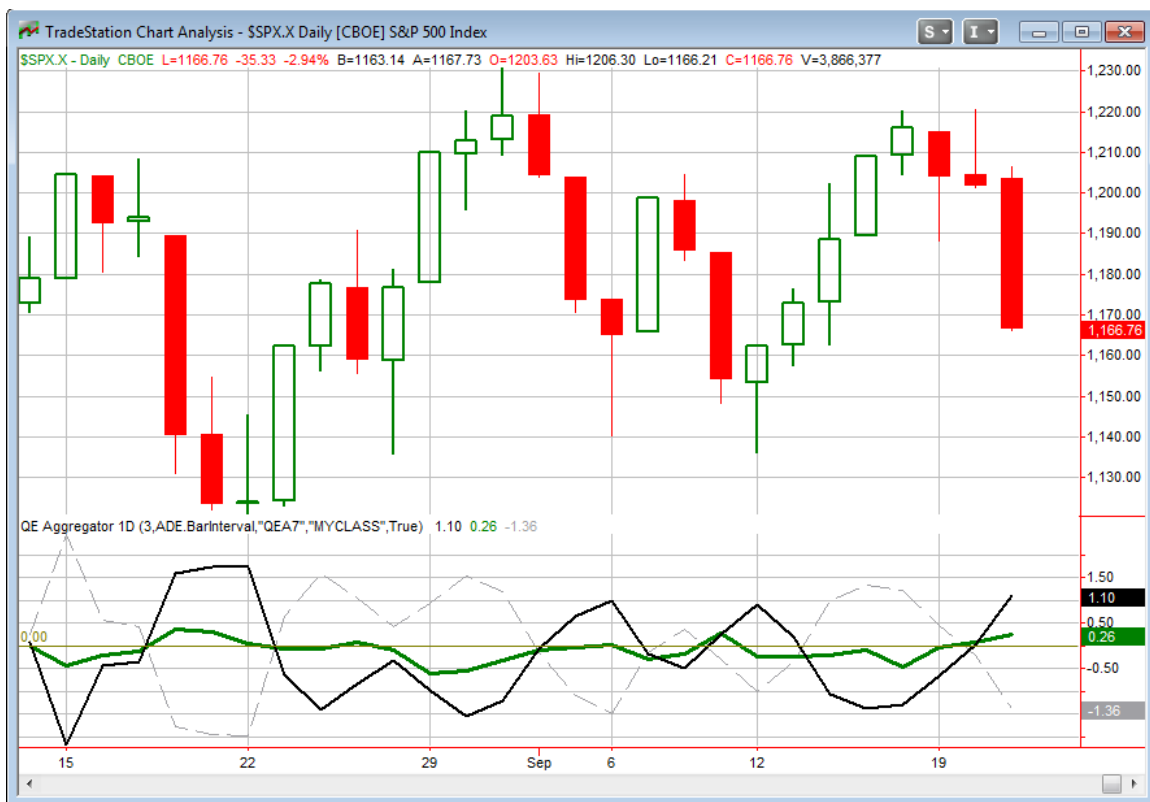
The only yellow flag here is that the average drawdown is fairly large at 1.3%. Still, while results here are good, I believe they overstate the upside edge. While these results came out strong, several other tests did not. Below is an example that checked all Fed Days where the Fed Day marked exactly the 3<sup>rd</sup> day down in a row.

SPX closes down for exactly the 3rd day in a row. Today is a Fed Day.  
Buy on close. Sell X days later. \$100k/trade. 1982 - 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	911.27	13	9	4	69.23	1,204.96	-2,483.35	0.49	1.09	70.10
4	534.09	13	7	6	53.85	1,374.54	-1,514.61	0.91	1.06	41.08
3	3,176.33	13	7	6	53.85	1,211.71	-884.28	1.37	1.60	244.33
2	4,393.87	13	9	4	69.23	836.95	-784.67	1.07	2.40	337.99
1	471.84	13	6	7	46.15	881.15	-687.87	1.28	1.10	36.30

The possible upside edge here is much more moderate and typical of what I saw tonight.

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



Today's studies caused the green Aggregator line to rise further into positive territory. Levels above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the Differential Line is also stretched well above 0. A positive Differential reading means the SPX has underperformed expectations over the last few

days. So net expectations are positive and the SPX is oversold versus recent expectations. Historically this combination has suggested a bullish edge. Bullish configurations can be seen on the chart whenever both lines close above 0. Due to this the Aggregator System remained long at the close.

Based on the current active studies the green Aggregator line is poised to remain above 0 on Thursday. Of course this could change if compelling bearish studies emerge. Meanwhile, the Differential Pivot will be 1,195.83. This is 2.5% above Wednesday's close. In other words, the SPX would need to close higher by at least this much in order to flip from "oversold" to "overbought".

The late selloff on Tuesday that caused the shorts to be covered and the long trade to trigger was unfortunate. The Aggregator had been nicely in sync with the market in recent weeks, but in this case it was a bit early. While the Aggregator is suggesting an upside edge at the moment, I am not terribly excited about it. Tonight's studies appeared underwhelming considering the size of the selloff. Also the market still has a bit further to fall before it would be testing its recent lows. As volatile and dangerous as the environment has been over the last 2 months, I don't think I want to begin building a large long position just yet. Therefore, rather than scaling in as I often do, I will simply hold on to the small ¼ size position I currently hold. I may miss out here, but I prefer a little caution on the long-side right now. The one trade I am interested in is the Catapult that triggered in SLB. I have listed it 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.**

<b>X Days</b>	<b>All: Net Profit</b>	<b>All: Total Trades</b>	<b>All: Winning Trades</b>	<b>All: Losing Trades</b>	<b>All: % Profitable</b>	<b>All: Avg Winning Trade</b>	<b>All: Avg Losing Trade</b>	<b>All: Win/Loss Ratio</b>	<b>All: ProfitFactor</b>	<b>All: Avg Trade</b>
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

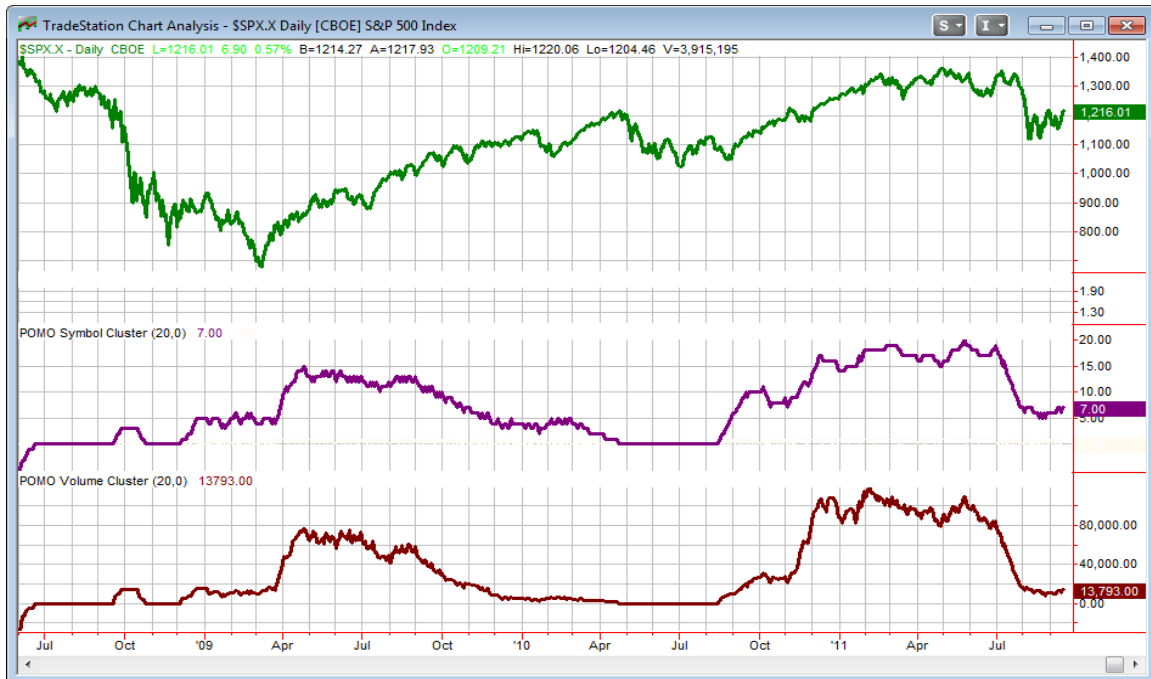
**We are currently between 120 and 130 days from the 3/21/11 instance when the SPX closed at 1,298.38.**

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***

*New*

SLB – buy 1/3 position @ \$65.15.

#### ***Catapult for ETF's Trades***

None.

#### ***Broad Market Large Cap CBI – 1(SLB)***

### **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.*

*SLB – buy 1/3 position @ \$65.15 limit.* From catapult section above.

### **Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	9/20/2011	\$120.17	\$116.63	-2.95%		Aggregator

This report has been prepared by Hanna Capital Management, LLC and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy securities. While information contained herein is believed to be accurate at the time of publication, we make no representation as to the accuracy or completeness of any data, studies, or opinions expressed and it should not be relied upon as such. Robert Hanna, Hanna Capital Management, LLC or clients of Hanna Capital Management, LLC may have positions or other interests in securities (including derivatives) directly or indirectly which are the subject of this report. This report is provided solely for the information of Hanna Capital Management, LLC clients and prospects who are expected to make their own investment decisions without reliance upon this report. Neither Hanna Capital Management, LLC nor any officer or employee of Hanna Capital Management, LLC accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report may not be reproduced, distributed or published by any recipient for any purpose without the prior express consent of Hanna Capital Management, LLC.

Copyright © 2011 Hanna Capital Management, LLC.