

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 23, 2011

Volume 4 Issue 184

Market Overview



Signals Overview

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

Tonight's Research Points

- Back to back bad breadth days under the 200ma are often followed by a bounce.
- 3% drops from short-term lows suggest a short-term upside edge.
- The late rally may have dampened Friday's outlook a bit.

Short-term Outlook

The Bottom Line

The Aggregator suggests an upside edge. I wasn't impressed last night, but now I am. I will look to add both index shares and individual stocks on Friday/

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
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%
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	
July 5, 2011	QE2 Over	int term	Bearish	
March 22, 2011	3 Days Up Issues % > 70%	8 months	Bullish	19.00%
Dropped Tonight				
September 21, 2011	Bottom 25% daily range b4 Fed Day	1 day	Bullish	
September 20, 2011	Low volume drop from overbough	1-2 days	Bearish	
September 19, 2011	Overbought post Sept opex	1-4 days	Bearish	-2.40%

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

The Evidence

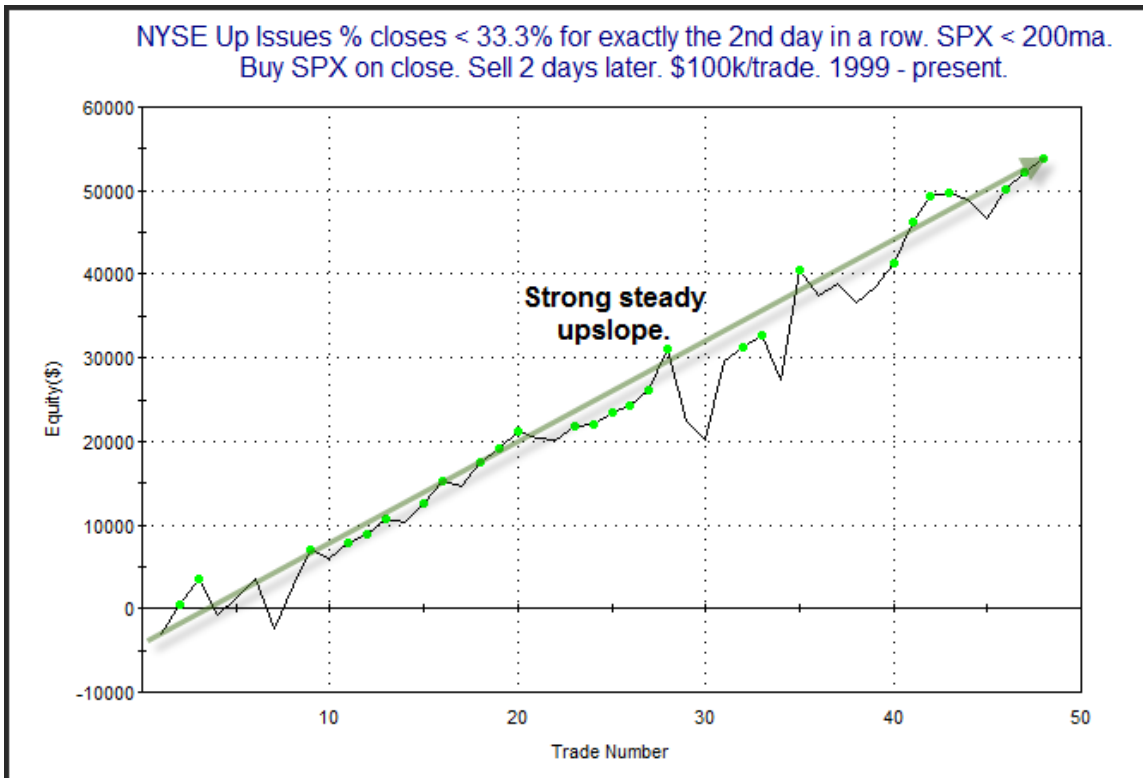
Thursday saw another big selloff. After closing up every day last week, the SPX is now just 1 day from closing down every day this week. Thursday saw the SPX, the Nasdaq and the Russell 2000 all fall between 3.1% and 3.3%. Breadth was extremely negative. The NYSE Up Issues % came in at 12% and the Up Volume % was 5%. Total NYSE volume spiked to the highest level since August.

There were a good number of studies that triggered in the Quantifinder tonight, but all of them basically carried the same message. The selling has become overdone and we are likely to see a bounce soon. The study below doesn't stand out greatly in its requirements from the others. The results are certainly compelling, though, and the sample size is quite large. It looks at buying after 2 days of very negative breadth during a downtrend. Last seen in the 9/12/11 subscriber letter, I have updated all results.

NYSE Up Issues % closes < 33.3% for exactly the 2nd day in a row. SPX < 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1999 - 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	54,500.21	42	30	12	71.43	3,008.71	-2,980.10	1.01	2.52	1,297.62
4	35,674.83	45	27	18	60.00	3,104.88	-2,675.38	1.16	1.74	792.77
3	39,475.90	48	29	19	60.42	3,500.95	-3,265.88	1.07	1.64	822.41
2	53,796.55	48	33	15	68.75	2,872.28	-2,732.59	1.05	2.31	1,120.76
1	38,755.06	48	31	17	64.58	2,055.22	-1,468.05	1.40	2.55	807.40

46 of 48 instances (96%) closed above the entry price at some point in the next week. 47 of 48 did so within 6 trading days.

Results are extremely consistent. The stat at the bottom of the table is what seems most striking. Below is an equity curve using a 2-day exit.



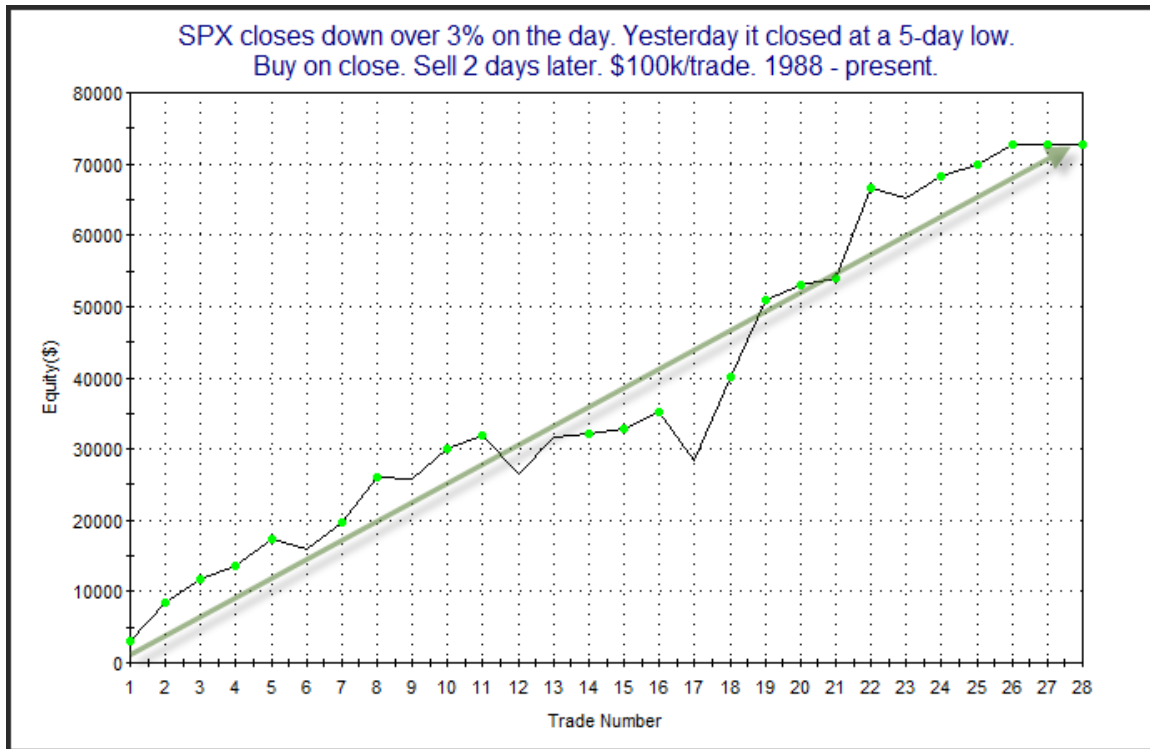
As I've mentioned in the past I especially like this study because it has produced such consistently positive returns in a downtrending environment. That's fairly unusual to see.

Another bullish aspect of today's drop is that the market was already short-term oversold when it occurred. This tends to increase the odds of success and the risk/reward. To see what I mean by this, let's consider the next 2 studies. They examine the returns produced by buying 3% drops. The 1st one requires that the market close at a 5-day low prior to the 3% drop. The 2nd one requires that the market close above a 5-day low prior to the 3% drop.

SPX closes down over 3% on the day. Yesterday it closed at a 5-day low.
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	87,648.58	26	19	7	73.08	5,380.15	-2,082.05	2.58	7.01	3,371.10
4	47,145.93	28	17	11	60.71	4,988.18	-3,423.01	1.46	2.25	1,683.78
3	58,335.38	29	19	10	65.52	4,364.55	-2,459.11	1.77	3.37	2,011.56
2	63,020.17	29	24	5	82.76	3,300.21	-3,236.97	1.02	4.89	2,173.11
1	44,202.68	31	21	10	67.74	2,979.65	-1,836.99	1.62	3.41	1,425.89

This is the situation we are in now. As you can see a strong edge is evident over the next couple of days. Below is an equity curve that demonstrates the consistency of the setup.



And so next is the same 3% drop without the 5-day low the day before.

SPX closes down over 3% on the day. Yesterday it closed > 5-day low.
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	-10,649.82	34	16	18	47.06	3,359.81	-3,578.16	0.94	0.83	-313.23
4	-22,310.92	36	15	21	41.67	3,475.31	-3,544.79	0.98	0.70	-619.75
3	-7.59	40	21	19	52.50	2,893.43	-3,198.41	0.90	1.00	-0.19
2	5,861.23	41	20	21	48.78	2,678.82	-2,272.15	1.18	1.12	142.96
1	1,864.39	42	25	17	59.52	1,664.51	-2,338.14	0.71	1.05	44.39

Same time period. Similar number of instances. No compelling edge. Of course we are now in the category of the previous study, which is bullish.

But not all the action Thursday was beneficial. The rally in the last ½ hour may have felt good to some traders, but it normally eats into the upside potential of the next day. To see this let us first look at 3% declines that finish the day within 1% of its low.

SPY closes down over 3% on the day and within 1% of its intraday low.
Buy on close. Sell 1 day later. \$100k/trade. 1993 - present.

TradeStation Performance Summary		Collapse ▲	
All Trades			
Total Net Profit	\$67,608.01	Profit Factor	2.97
Gross Profit	\$101,973.79	Gross Loss	(\$34,365.78)
Total Number of Trades	57	Percent Profitable	68.42%
Winning Trades	39	Losing Trades	18
Even Trades	0		
Avg. Trade Net Profit	\$1,186.11	Ratio Avg. Win:Avg. Loss	1.37
Avg. Winning Trade	\$2,614.71	Avg. Losing Trade	(\$1,909.21)
Largest Winning Trade	\$11,683.71	Largest Losing Trade	(\$7,417.30)

The numbers here are all impressive. Such poor finishes are often buyable. But now let's consider those instances like now where the SPY finished more than 1% above its intraday low.

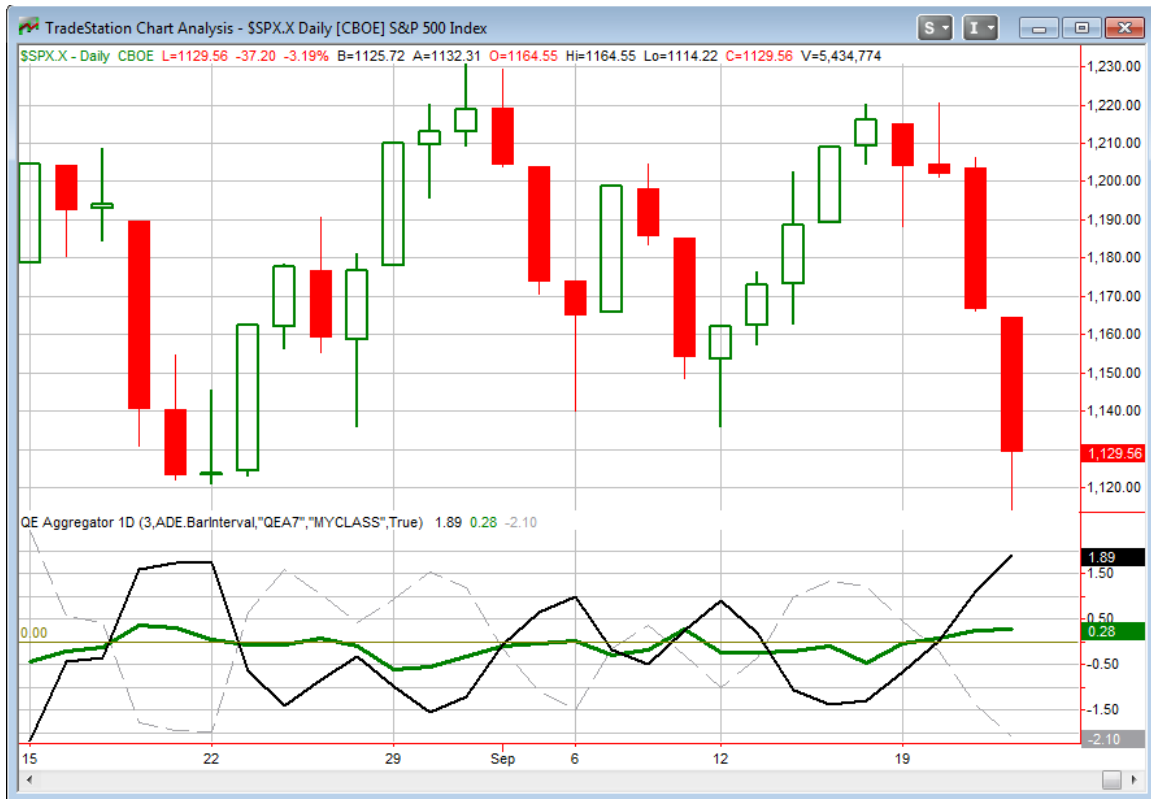
SPY closes down over 3% on the day but over 1% above its intraday low.
Buy on close. Sell 1 day later. \$100k/trade. 1993 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
03/08/96	Buy	\$63.50	1.15%	\$1,306.42
03/11/96	Sell	\$64.23		(\$676.82)
04/04/00	Buy	\$145.75	2.36%	\$3,471.16
04/05/00	Sell	\$149.19		\$0.00
04/14/00	Buy	\$135.50	3.87%	\$3,874.50
04/17/00	Sell	\$140.75		(\$597.78)
09/17/01	Buy	\$104.30	(0.24%)	\$958.00
09/18/01	Sell	\$104.05		(\$900.52)
10/06/08	Buy	\$104.72	(4.48%)	\$2,489.94
10/07/08	Sell	\$100.03		(\$4,836.78)
10/22/08	Buy	\$90.64	1.16%	\$1,996.43
10/23/08	Sell	\$91.69		(\$5,327.49)
10/24/08	Buy	\$87.04	(3.55%)	\$2,835.56
10/27/08	Sell	\$83.95		(\$3,834.32)
11/05/08	Buy	\$96.19	(5.54%)	\$0.00
11/06/08	Sell	\$90.86		(\$6,369.07)
11/11/08	Buy	\$89.77	(4.40%)	\$422.94
11/12/08	Sell	\$85.82		(\$5,175.45)
03/30/09	Buy	\$78.79	0.93%	\$2,906.01
03/31/09	Sell	\$79.52		\$0.00
05/06/10	Buy	\$112.94	(1.49%)	\$734.55
05/07/10	Sell	\$111.26		(\$2,973.60)

The average trade here is a loss of 0.9%.

Instances are pretty well split, and the number of occurrences is low, but the end results are considerably worse than if the SPY closed near its low.

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



Today's studies again 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 stretched very far 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 extremely 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 Friday. Of course this could change if compelling bearish studies emerge. Meanwhile, the Differential Pivot will be 1193.89. This is a whopping 5.7% above Thursday'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". That is highly unlikely. It will probably take a multi-day rally at this point in order to flip the Differential line.

I mentioned last night that I thought this market might be headed towards a retest of recent lows. I did not envision getting there so quickly. If I had anticipated that occurring I may have placed a buy order near the support area. The late-day bounce

makes it more difficult to get a good entry price, but that is what I will try. I will be looking to add to my small index position tomorrow should the SPY dip intraday. More aggressive traders could consider using a higher limit price. 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

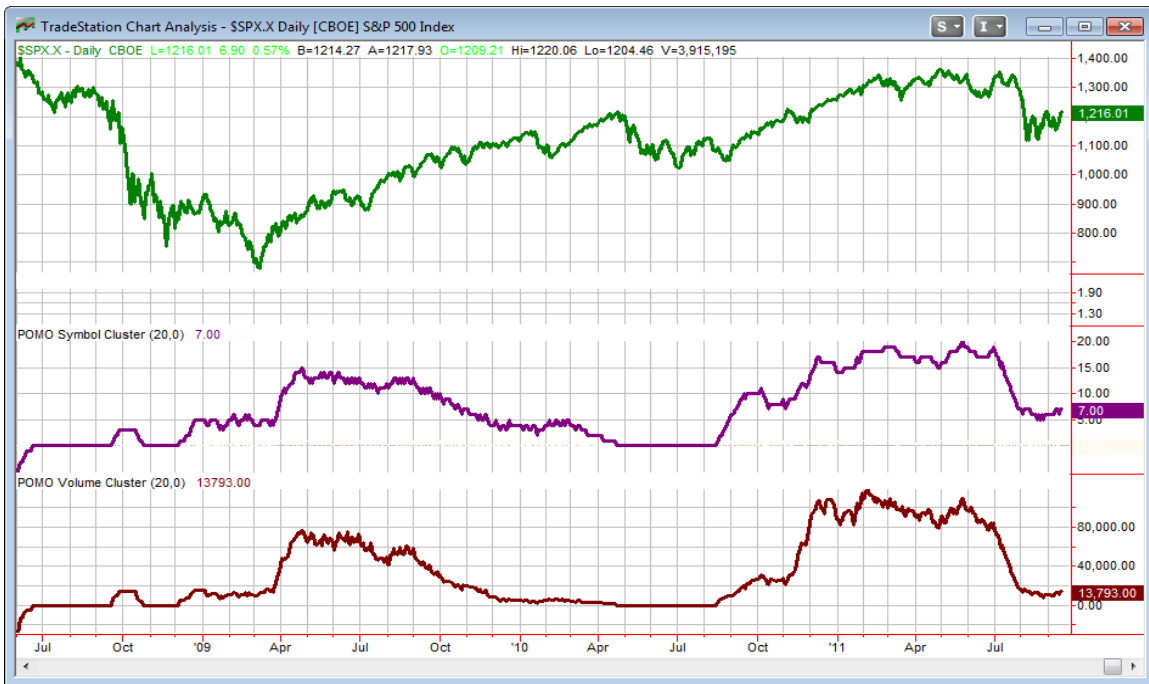
We are currently between 120 and 130 days from the 3/21/11 instance when the SPX closed at 1,298.38.

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 3rd 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

SLB – bought 1/3 position @ \$65.15.

New

SLB – buy 1/3 position @ \$61.58

APA – buy 1/3 position @ \$83.69

FCX – buy 1/3 position @ \$32.14

Catapult for ETF's Trades

None.

Broad Market Large Cap CBI – 4/3 (SLB-2, APA, FCX)

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 @ \$61.58 limit. From catapult section above.

APA – buy 1/3 position @ \$83.69. From catapult section above.

FCX – buy 1/3 position @ \$32.14. From catapult section above.

SPY – buy 1/4 index position @ \$112.00 Based on short-term outlook above. I will look to enter if the SPY trades down about 1/2 way between its Thursday's closing price and low.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	9/20/2011	\$120.17	\$112.86	-6.08%		Aggregator
SLB(1/3)	9/22/2011	\$62.49	\$61.58	-1.46%		Catapult

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