

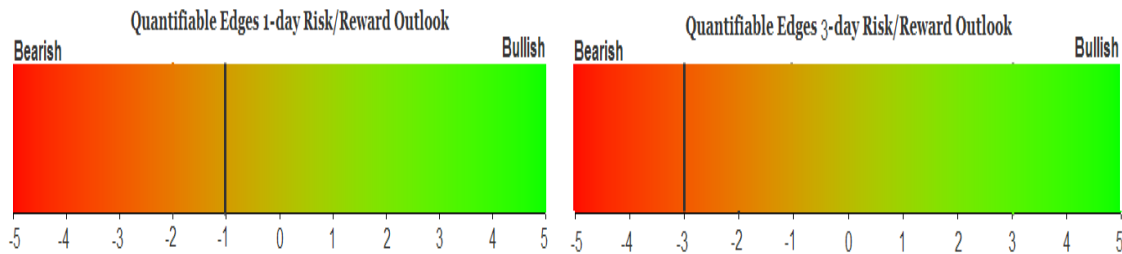
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 28, 2011

Volume 4 Issue 187

Market Overview



Signals Overview

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

Tonight's Research Points

- 2 strong breadth days in a downtrend is not the bearish edge it used to be.
- SPY closing up but well off its high suggest a short-term upside edge.
- 3 up days without confirming volume or a 50-day low just prior suggests a short-term downside edge.

Short-term Outlook

The Bottom Line

My outlook has turned negative. I will be looking to take on some short exposure if I can get a favorable entry price.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
September 28, 2011	3 up. Vol weak. No 50-low. Close < 200	1-3 days	Bearish	
September 28, 2011	SPY 1% below high but up 1% on day	1-2 days	Bullish	
September 27, 2011	2 days up from 20-low but < 3 days ago	1-2 days	Bearish	-1.20%
September 26, 2011	Bounce < 25% yesterday's drop	1-4 days	Bearish	
September 21, 2011	1% up 10-high then close down	1-7 days	Bullish	3.25%
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 26, 2011	Inside day up after 20-day low	1-2 days	Bearish	

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

The Evidence

After gapping up and moving strongly higher for most of the day, the market gave back a big chunk of its gains in late selling. It still managed to see the SPX rise 1.1%, the Nasdaq gain 1.2% and the Russell 2000 close up 2.2%. Breadth was strongly positive as the NYSE Up Issues % came in at 81% and the Up Volume % was 79%. Thanks to a late push, total NYSE volume came in slightly higher than Monday.

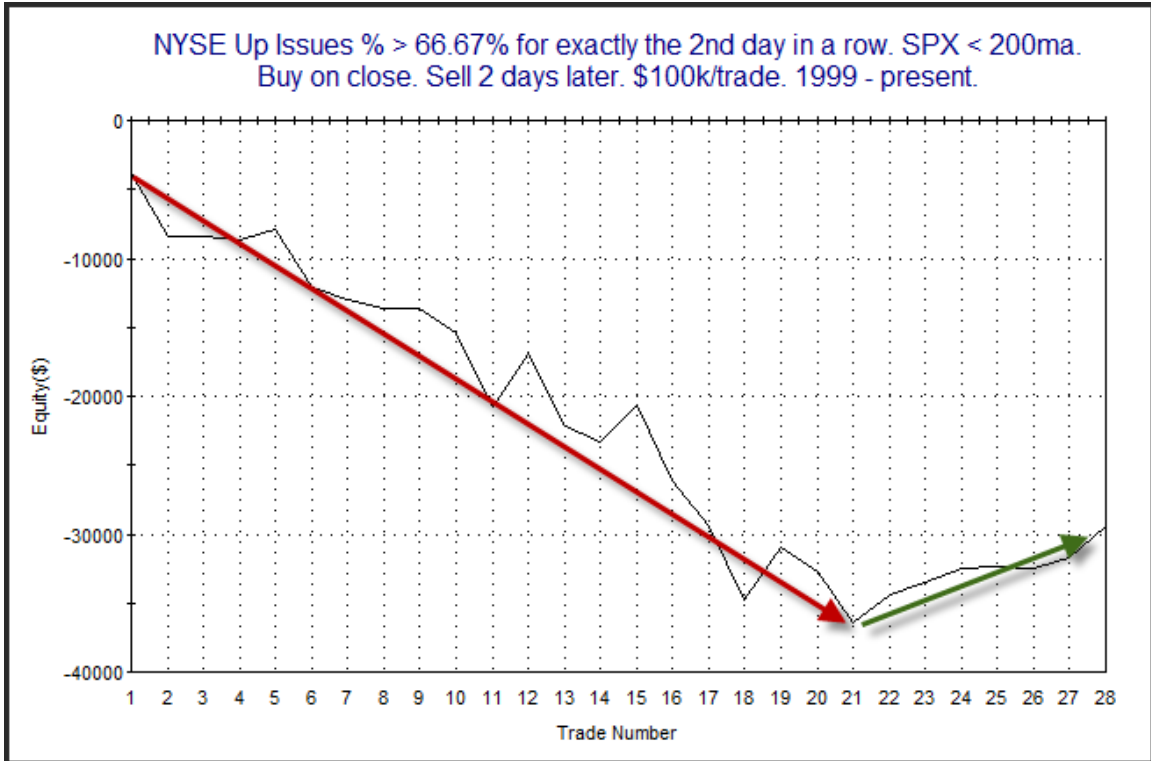
Action has been a little bit frustrating lately. Not because the market isn't acting as I expect, but because generating the expectations can sometimes be a difficult task if the market is moving swiftly and/or changing direction as we approach the close. With about 40 minutes left in the day it seemed apparent that the Aggregator was going to give a short signal. But the large selloff in the last 40 minutes muddled the picture. After going about 8 months without getting any signals wrong or confused as we approached the bell, this is the 3rd time in September that the signal was unclear. In the end, mixed studies did trigger a short signal. Let's look at how it came about and some of the studies I examined.

This first study was last seen in the 6/14/10 subscriber letter. It looks at instances of back-to-back strong breadth days while the SPX is under its 200ma. All stats have been updated.

NYSE Up Issues % > 66.67% for exactly the 2nd day in a row. SPX < 200ma. Buy 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
10	-36,404.59	23	10	13	43.48	2,087.25	-4,405.93	0.47	0.36	-1,582.81
9	-43,351.43	24	10	14	41.67	1,855.44	-4,421.84	0.42	0.30	-1,806.31
8	-35,856.82	24	10	14	41.67	1,609.15	-3,710.60	0.43	0.31	-1,494.03
7	-37,780.73	24	8	16	33.33	2,142.96	-3,432.78	0.62	0.31	-1,574.20
6	-28,829.00	25	11	14	44.00	1,930.27	-3,575.86	0.54	0.42	-1,153.16
5	-28,393.13	25	10	15	40.00	1,624.48	-2,975.86	0.55	0.36	-1,135.73
4	-31,860.91	27	11	16	40.74	1,420.50	-2,967.90	0.48	0.33	-1,180.03
3	-19,603.22	28	12	16	42.86	1,844.56	-2,608.62	0.71	0.53	-700.11
2	-29,431.74	28	10	18	35.71	1,828.40	-2,650.87	0.69	0.38	-1,051.13
1	-18,954.15	28	12	16	42.86	1,012.55	-1,944.05	0.52	0.39	-676.93

Upon first glance the edge appears to be solidly negative. But if you look back at the 6/14/10 letter you'll see the numbers were much worse then. A large part of the

downside edge appears to play out in the 1st 2 days. Below is an equity curve assuming a 2-day holding period.



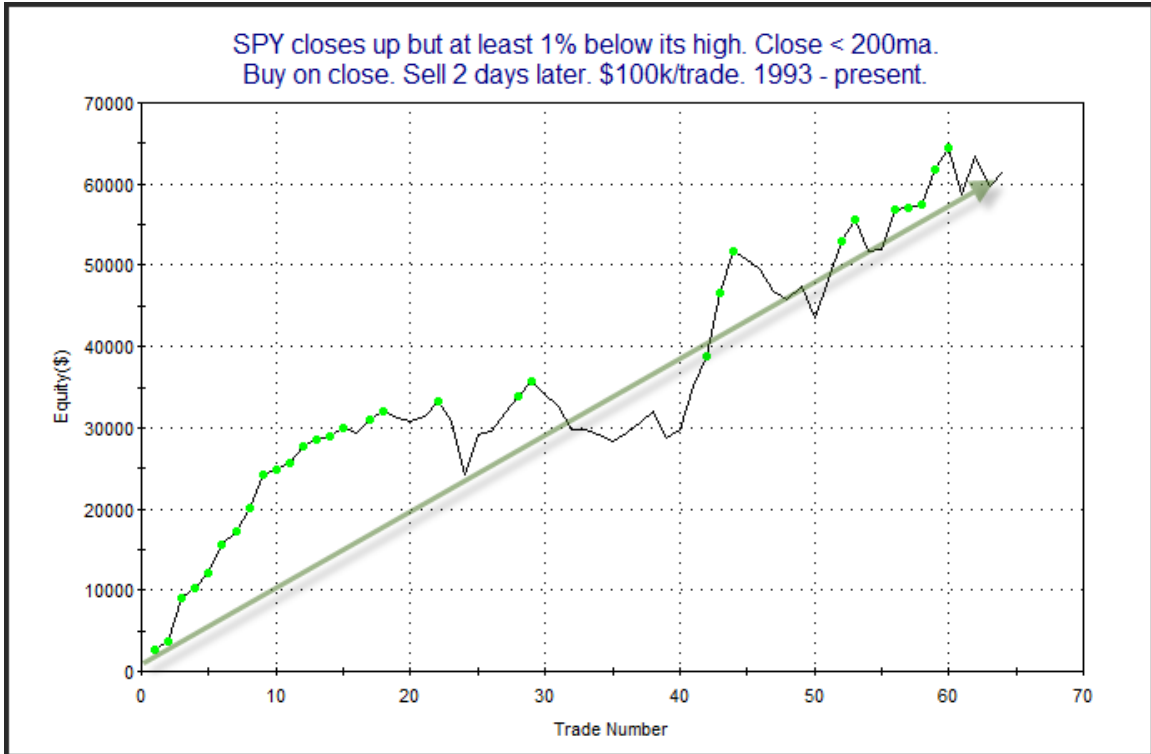
After a long stretch of very consistent negative results, the curve has turned up. In fact, 6 of the last 7 instances have closed higher. Below is a list of the last 7 instances.

NYSE Up Issues % > 66.67% for exactly the 2nd day in a row. SPX < 200ma. Buy on close. Sell 2 days later. \$100k/trade. Last 7 instances.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
06/11/10	Buy	\$1,091.60	2.16%	\$2,183.09
06/15/10	Sell	\$1,115.23		(\$233.87)
07/08/10	Buy	\$1,070.25	0.79%	\$979.29
07/12/10	Sell	\$1,078.75		(\$199.95)
07/23/10	Buy	\$1,102.66	1.01%	\$1,646.10
07/27/10	Sell	\$1,113.84		(\$122.40)
09/02/10	Buy	\$1,090.10	0.16%	\$1,365.00
09/07/10	Sell	\$1,091.84		\$0.00
08/24/11	Buy	\$1,177.60	(0.07%)	\$1,098.72
08/26/11	Sell	\$1,176.80		(\$3,501.96)
08/29/11	Buy	\$1,210.08	0.73%	\$1,691.66
08/31/11	Sell	\$1,218.89		(\$1,173.42)
09/14/11	Buy	\$1,188.68	2.30%	\$2,635.92
09/16/11	Sell	\$1,216.01		\$0.00

You also notice that even the lone gainer only gained less than 0.1%. I noted a few studies like this as the close approached and felt perhaps the downside inclinations were weakening somewhat. I also noticed studies with bullish implications. When SPY closes higher but well off its highs of the day, then it has a tendency to rise back towards (or above) those highs over the next few days. This can be seen in the study below, which was last shown in the 7/7/10 letter. (Stats updated.)

SPY closes up but at least 1% below its high. 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	58,460.23	45	28	17	62.22	4,465.26	-3,915.70	1.14	1.88	1,299.12
9	51,048.61	47	27	20	57.45	4,396.53	-3,382.88	1.30	1.75	1,086.14
8	35,428.74	47	24	23	51.06	4,473.62	-3,127.74	1.43	1.49	753.80
7	37,140.10	50	29	21	58.00	4,558.46	-4,526.44	1.01	1.39	742.80
6	34,188.61	53	29	24	54.72	4,101.14	-3,531.02	1.16	1.40	645.07
5	41,040.91	55	29	25	52.73	3,815.95	-2,784.87	1.37	1.59	746.20
4	38,217.45	57	33	24	57.89	3,236.05	-2,857.18	1.13	1.56	670.48
3	44,503.31	59	35	24	59.32	3,026.72	-2,559.66	1.18	1.72	754.29
2	61,612.02	64	44	20	68.75	2,423.20	-2,250.45	1.08	2.37	962.69
1	32,121.57	71	45	26	63.38	1,754.02	-1,800.36	0.97	1.69	452.42

Ample occurrences and solid numbers over the first few days appear to suggest an upside edge. Below is an equity curve with a 2-day exit strategy.



A little choppy but the general upslope remains intact throughout, providing further evidence of an upside edge. I also looked at a similar study a few weeks ago in the 9/15/11 subscriber letter. In that case I ignored the 200ma, but required the SPY close up at least 1% on the day even though it was also 1% below its intraday high. Updated results of that study are below.

SPY closes 1% below its high but still up > 1% on the day.
Buy on close. Sell X days later. \$100k/trade. 1993 - present.

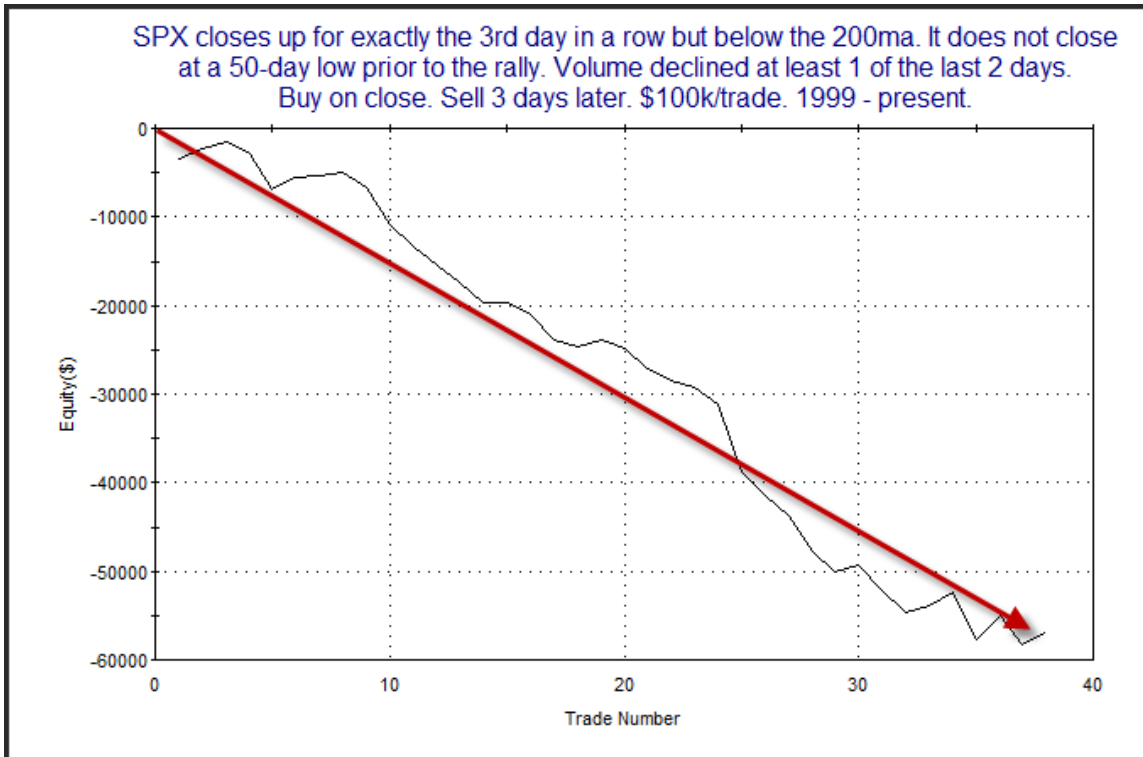
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	43,399.23	19	13	6	68.42	5,812.26	-5,360.03	1.08	2.35	2,284.17
9	47,107.26	20	11	9	55.00	6,289.76	-2,453.34	2.56	3.13	2,355.36
8	28,804.14	20	10	10	50.00	5,240.24	-2,359.82	2.22	2.22	1,440.21
7	23,957.18	21	13	8	61.90	4,681.81	-4,613.30	1.01	1.65	1,140.82
6	27,695.44	21	14	7	66.67	3,989.40	-4,022.30	0.99	1.98	1,318.83
5	21,273.52	22	13	9	59.09	3,223.19	-2,291.99	1.41	2.03	966.98
4	24,125.68	23	14	9	60.87	3,318.46	-2,481.42	1.34	2.08	1,048.94
3	19,428.87	24	14	10	58.33	3,059.56	-2,340.50	1.31	1.83	809.54
2	21,685.29	24	19	5	79.17	1,853.59	-2,706.57	0.68	2.60	903.55
1	12,021.07	27	19	8	70.37	1,355.29	-1,716.19	0.79	1.88	445.22

As you can see, returns over the first couple of days are very close to the previous study. In this case the consistency is even better, though.

But as I mentioned, the Aggregator signal came out short. That was because of the study shown below, which was seen in the 9/13/10 letter. (Stats are also updated here.)

SPX closes up for exactly the 3rd day in a row but below the 200ma. It does not close at a 50-day low prior to the rally. Volume declined at least 1 of the last 2 days. Buy 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	-42,253.03	35	14	21	40.00	1,496.53	-3,009.74	0.50	0.33	-1,207.23
4	-53,309.09	38	13	25	34.21	1,143.02	-2,726.74	0.42	0.22	-1,402.87
3	-56,910.63	38	11	27	28.95	1,053.50	-2,537.00	0.42	0.17	-1,497.65
2	-35,331.68	38	9	29	23.68	893.02	-1,495.48	0.60	0.19	-929.78
1	-16,757.36	38	15	23	39.47	1,108.02	-1,451.21	0.76	0.50	-440.98
34 of 38 instances (89.5%) closed below the entry price at some point in the next week.										

The results appear to be very consistent and the size of the downside edge is impressive looking out 3 days. The first 2 days basically work to offset the first 2 days of the previous study, but day 3 is solely owned by this study. Below is an equity curve that assumes a 3-day holding period.



The curve is remarkably consistent. One concern I did have is the filter that excludes any 3-day up moves that originate from a 50-day low. While the last 3 days did not come from a 50-day low, they did start from a 20-day low. Therefore, I decided to look at other times the market was coming from a 20-day, but not a 50-day low. Below are results assuming a 2-day holding period.

SPX closes up for exactly the 3rd day in a row but below the 200ma. It does not close at a 50-day low prior to the rally, *but it DOES close at a 20-day low prior to the rally*. Volume declined at least 1 of the last 2 days.
Buy on close. Sell 2 days later. \$100k/trade. 1999 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
12/18/01	Buy	\$1,142.92	(0.26%)	\$828.24
12/20/01	Sell	\$1,139.93		(\$710.79)
01/25/02	Buy	\$1,133.28	(2.88%)	\$470.80
01/29/02	Sell	\$1,100.64		(\$3,039.52)
06/16/08	Buy	\$1,360.14	(1.64%)	\$470.85
06/18/08	Sell	\$1,337.84		(\$1,952.02)
09/12/08	Buy	\$1,251.70	(3.05%)	\$0.00
09/16/08	Sell	\$1,213.57		(\$6,511.18)

Only 4 instances is not near enough to base a trade on. But with all 4 pointing south it is enough to suggest my fears regarding the use of the 50-day low filter are unwarranted. I therefore elected to leave the previous study as it was and include it on the active list. One last note about this study is that I looked to see whether it mattered which day volume came in lighter. It didn't.

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



With the new bearish study being the only one that looks out as far as 3 days the green Aggregator line fell further into negative territory. Levels below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the Differential Line took a sharp dive down 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 mildly overbought versus recent expectations. Historically this combination has suggested a downside edge. The configuration can be seen on the chart whenever both lines close below 0. Due to this the Aggregator System turned from flat to short at the close.

At this point the green Aggregator line is poised to remain below 0 on Wednesday. Of course this could change if compelling bullish studies emerge. Meanwhile, the Differential Pivot will be 1,142.57. This is about 2.8% below Tuesday's close. In other words, it would take an SPX decline of at least this much on Wednesday to flip the Differential line back to positive. It's unlikely we'll see that achieved in just 1 day.

While 3-day expectations are negative, that is basically thanks to day 3. Over the next 2 days expectations are currently very, very, slightly positive. This suggests to me the probability that I may be able to get a favorable entry price if I show some patience. I do not want to chase the market. So I will be looking for 1 of the following scenarios in which to enter on Wednesday: 1) a gap up, 2) an intraday move up near Tuesday's highs, or 3) a higher close. Should any of those occur I will begin building a SPY position. Details are in the Trade Ideas section below.

Intermediate-term Outlook (2 weeks – 2 months)– updated 9/26 – slightly bearish

If not for the small bounce on Friday, we would've seen every day close lower this past week. That's quite a contrast to the week before when every day closed higher. While the movement the last two weeks up and down has been sizable, it has been completely contained by the trading range established between 8/9/11 and 8/31/11. The market is down near the lower end of its range now, but until we see a decisive break it may not be a good idea to choose sides.

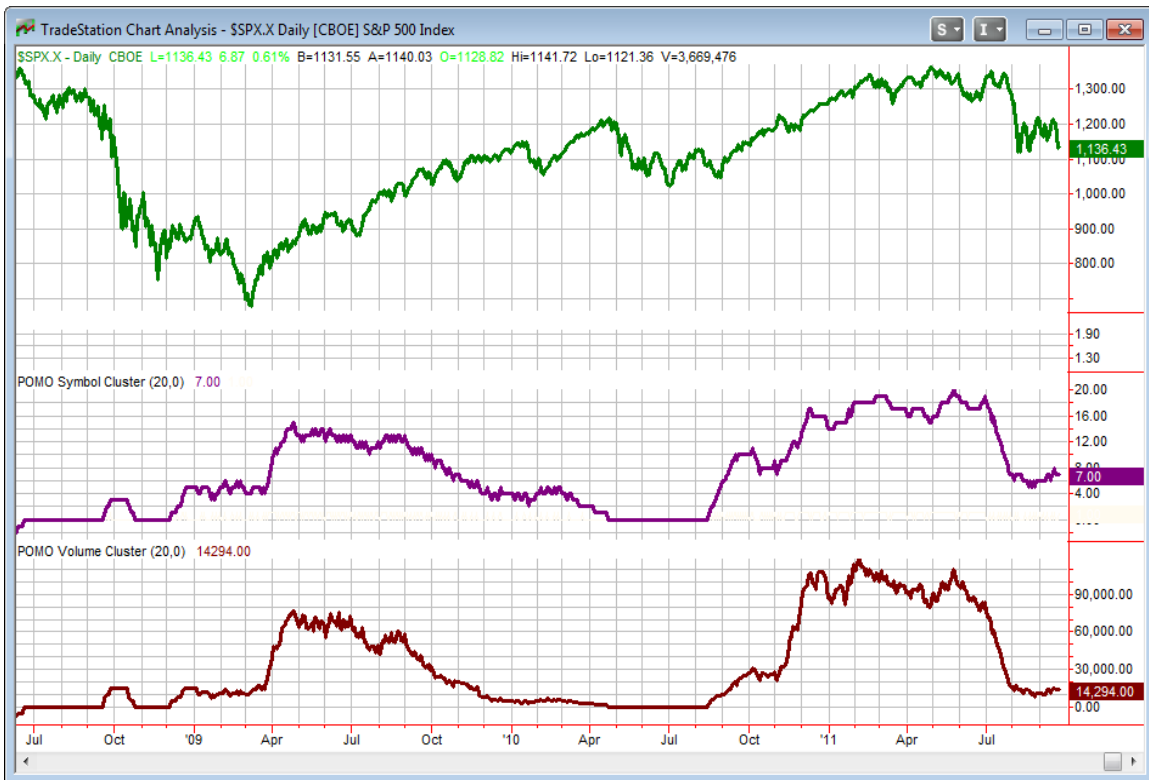
I didn't notice any study this past week that suggested compelling intermediate-term implications, but that doesn't mean nothing of intermediate-term import occurred. The big news occurred on Wednesday when the Fed provided some details of "Operation Twist". It is their next attempt to stimulate the economy.

QE1 and QE2 were there last two attempts. Those programs appeared to have a strongly bullish impact on stock prices. Gains were significant during both. The objective of both programs was to inject liquidity into the system by purchasing treasury securities in the open market. Operation Twist is different in that the fed will be buying longer dated securities and selling shorter dated securities. Exactly how it will all unfold is unclear, but I'll be sure to monitor it closely and the net buying numbers will be reflected the POMO chart.

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. And without any program in place the market has struggled mightily over the last several years. It will be interesting to see how Operation Twist impacts the market. My initial thoughts are below.

Being that this is not a straight liquidity injection like we saw in QE1 and QE2, the impact may not be as broad. It could be that certain industries or groups will benefit from

the yield curve shift the fed is forcing while other groups will be negatively impacted. I don't know at this point how this will play out, but I do think it may be worthwhile to track sector relative strength as operation twist gets underway. I'll conduct some more research in this area over the next several weeks, but as a starting point I thought it would be interesting to take a look at the best and worst performing sectors since Tuesday's close.

Sector ETF Returns Over Last 3 Days		
Symbol	Description	%Chg
		%Chg
XLU	S&P Sel Utilities Spdr Fund	-2.54
XLK	S&P Sel Technology Spdr Fund	-3.46
XLP	S&P Sel Consum Staples Spdr Fu	-3.72
XLV	S&P Sel Health Care Spdr Fund	-4.63
XLY	S&P Sel Consum Discretion'y Sp	-4.72
IYZ	iShares DJ US Telecom Sect Ind	-5.91
XLF	S&P Sel Financial Spdr Fund	-6.71
XLI	S&P Sel Industrial Spdr Fund	-6.77
IYT	iShares DJ Transp Avg Ind Fd	-7.27
IYR	iShares DJ US R/E Index Tr	-7.44
XLB	S&P Sel Materials Spdr Fund	-10.03
XLE	S&P Sel Energy Spdr Fund	-10.55

Everything has fallen, but the disparity so far is quite large. Utilities, technology, and consumer staples have held up relatively well over the last 3 days while real estate, materials, and energy have been whacked. There is a good chance this initial thrust down is a short-term overreaction, but I'll start showing this table using a few different time frames going forward. Doing so may provide some insight into what groups are benefitting from Operation Twist, and what ones aren't.

Of course there are always groups that lead and groups that lag, but my suspicion is that the difference between the 2 may become more pronounced and more persistent thanks to the yield curve manipulation of Operation Twist. This isn't an original idea of mine. As some subscribers may be aware I am a member of the American Association of Professional Technical Analysts (AAPTA). Ken Safian, who is a long-time AAPTA member, suggested this idea to the AAPTA group this past week. He also discussed how the Fed took on a similar operation in 1961. In 1961 it seemed to help create a large disparity between growth and cyclical stocks. There is no telling at this point how this theory will pan out, but I do think paying a little extra attention to sector strength may be worthwhile.

Overall, I'll continue to slightly favor the short side with my index trades until more signs of a bottom emerge. I'll also take a keen interest in the effects of Operation Twist and anticipate measuring them through us of the POMO chart and industry group analysis.

Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

Open Catapult Triggers

APA – bought 1/3 position @ \$82.91

APA – bought 1/3 position @ \$82.73 (2nd lot)

Catapult for ETF's Trades

None.

Broad Market Large Cap CBI – 2/1 (APA-2)

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 – short ¼ index position if any of the follow are met 1) SPY opens at \$117.55 or higher, 2) SPY hits \$119.25 intraday, or 3) SPY closes >= \$117.55. To clarify, I am only looking for 1 lot. If not filled on open, I will cancel that order and place the \$119.25 limit order. If not filled on that during the day I will then short @ \$117.55 or higher at the close. This trade is based on the short-term outlook above.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
<i>SPY(1/4)</i>	<i>9/20/2011</i>	<i>\$120.17</i>	<i>\$118.53</i>	<i>-1.36%</i>		<i>sold on open</i>
<i>SLB(1/3)</i>	<i>9/22/2011</i>	<i>\$62.49</i>	<i>\$64.24</i>	<i>2.80%</i>		<i>hit intraday stop</i>
<i>SLB(1/3)</i>	<i>9/23/2011</i>	<i>\$60.50</i>	<i>\$64.24</i>	<i>6.18%</i>		<i>hit intraday stop</i>
APA(1/3)	9/23/2011	\$82.91	\$85.86	3.56%		Catapult
<i>FCX(1/3)</i>	<i>9/23/2011</i>	<i>\$31.40</i>	<i>\$34.89</i>	<i>11.11%</i>		<i>hit intraday stop</i>
<i>SLB(1/3)</i>	<i>9/26/2011</i>	<i>\$61.20</i>	<i>\$64.24</i>	<i>4.97%</i>		<i>hit intraday stop</i>
APA(1/3)	9/26/2011	\$82.73	\$85.86	3.78%		Catapult
<i>AA(1/3)</i>	<i>9/26/2011</i>	<i>\$10.07</i>	<i>\$10.59</i>	<i>5.16%</i>		<i>hit intraday stop</i>
<i>HAL(1/3)</i>	<i>9/26/2011</i>	<i>\$31.67</i>	<i>\$34.49</i>	<i>8.90%</i>		<i>hit intraday stop</i>

Several of the Catapult trades reached their intraday targets and were stopped out at the levels I sent out in the intraday update to gold subscribers. Only APA remains.

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.