

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 5, 2011

Volume 4 Issue 192

Market Overview



Signals Overview

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

Tonight's Research Points

- 5 lower lows, an intermediate-term low, and a reversal higher often lead to further upside over the next few days.
- The relatively high volume on the reversal also hints at an upside edge.

Short-term Outlook

The Bottom Line

There were some positive aspects to the turnaround on Tuesday. It appears the bounce may have further to go. I am still holding on to my partial long position.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
October 5, 2011	100-day low. Strong rise. High volume.	1-3 days	Bullish	
October 5, 2011	5 lower lows. 50-day low. Up close.	1-3 days	Bullish	
October 4, 2011	33% Up Issues % 2 days in a row. C<200	1-2 days	Bullish	
October 4, 2011	2.5% drop from 5-day low	1-2 days	Bullish	
Active - Long Term				
September 12, 2011	Nasdaq leading SPX	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				
October 3, 2011	1.75% drop 2 of 3 days. No 7-day low.	1-2 days	Bullish	3.40%

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

The Evidence

We were looking for a Turnaround Tuesday, and that was about the turnarounds we've seen in a long time. After a big gap down to open the day and the SPX trading over 2% lower intraday, it finished up over 2%. The Russell's turnaround was even larger. In the end the SPX gained 2.3%, the Nasdaq was up 3.0%, and the Russell 2000 rose 6.4%. Breadth was strong as the NYSE Up Issues % came in at 60% and the Up Volume % was 85%. Total NYSE volume spiked to the highest levels in over a week.

After breaking to new lows on Monday, the reversal in the SPX has set up a potential double-bottom pattern since it tested and has now re-crossed the August lows. Who knows if the double bottom will work, but I wouldn't be surprised if it at least got enough attention that the market managed to follow through for a few days. Of course that is just speculation, and not what this letter is about. Here I focus on quantification. And while computer scans for similar double bottom formations are difficult, I was able to examine some aspects of the reversal that suggested an upside edge.

Several different studies appeared that examined turnaround action for SPY. In my eyes a very important aspect of the turnaround to consider is that is occurred off of an intermediate-term low. It wasn't just some intraday dip that occurred in the middle of a trading range and saw the market finish strongly. The study below takes this into account and also considers the 5-day streak of lower lows that is in place along with the fact that the gains today were substantial.

After closing at a 100-day low yesterday, SPY makes at least the 5th lower low in a row today. It then closes up over 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
5	22,753.41	5	5	0	100.00	4,550.68	0.00	100.00	100.00	4,550.68
4	33,576.09	5	5	0	100.00	6,715.22	0.00	100.00	100.00	6,715.22
3	26,081.40	5	4	1	80.00	7,097.27	-2,307.69	3.08	12.30	5,216.28
2	12,090.23	5	3	2	60.00	4,572.13	-813.08	5.62	8.43	2,418.05
1	5,317.70	5	2	3	40.00	5,651.64	-1,995.19	2.83	1.89	1,063.54

Instances here are low but the results are remarkably strong. Below I have listed all instances assuming a 4-day exit

After closing at a 100-day low yesterday, SPY makes at least the 5th lower low in a row today. It then closes up over 1% on the day. Buy on close. Sell 4 days later. \$100k/trade. 1993 - present.

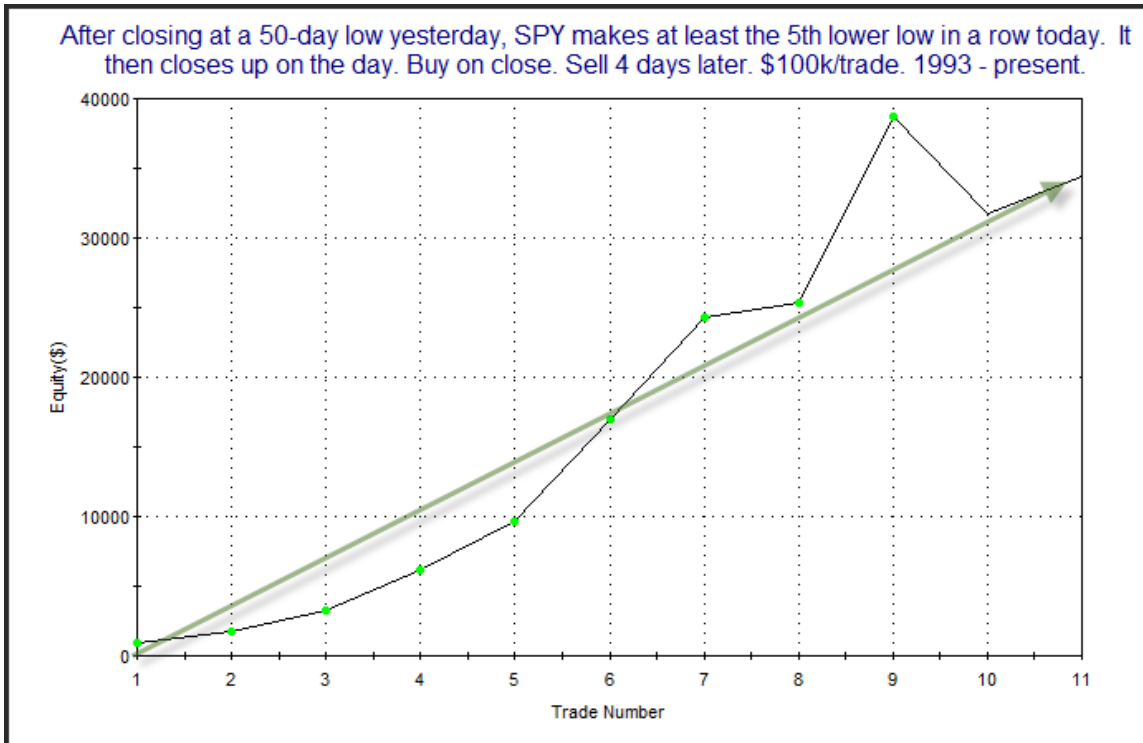
Date/Time	Signal	Price	% Profit	Run-up Drawdown
09/01/98	Buy	\$100.06	1.94%	\$5,184.81
09/17/98	Sell	\$102.00		(\$4,305.69)
07/24/02	Buy	\$84.72	7.35%	\$8,059.40
08/08/02	Sell	\$90.95		(\$3,681.60)
10/10/02	Buy	\$80.63	11.87%	\$12,734.80
10/25/02	Sell	\$90.20		\$0.00
11/21/08	Buy	\$79.52	12.55%	\$16,165.02
12/09/08	Sell	\$89.50		\$0.00
08/09/11	Buy	\$117.48	0.51%	\$3,165.72
08/24/11	Sell	\$118.08		(\$4,706.03)

Even the worst performer saw an additional intraday rise of 3.165% during the 4-day holding period. But as I said, there are too few instances to generate estimates. Therefore I loosened the requirements some and only required a 50-day low and an up close of any amount. This helped to generate a few more instances.

After closing at a 50-day low yesterday, SPY makes at least the 5th lower low in a row today. It then closes up 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
5	16,043.52	10	8	2	80.00	3,407.17	-5,606.93	0.61	2.43	1,604.35
4	34,452.65	11	10	1	90.91	4,133.51	-6,882.48	0.60	6.01	3,132.06
3	21,320.17	11	8	3	72.73	4,337.50	-4,459.95	0.97	2.59	1,938.20
2	14,791.49	11	8	3	72.73	2,655.11	-2,149.81	1.24	3.29	1,344.68
1	2,775.57	11	6	5	54.55	2,498.14	-2,442.65	1.02	1.23	252.32

Results here are not as powerful as the 1st study but they still suggest a substantial upside edge. Below is an equity curve that assumes a 4-day exit strategy.



I don't see anything terribly alarming here.

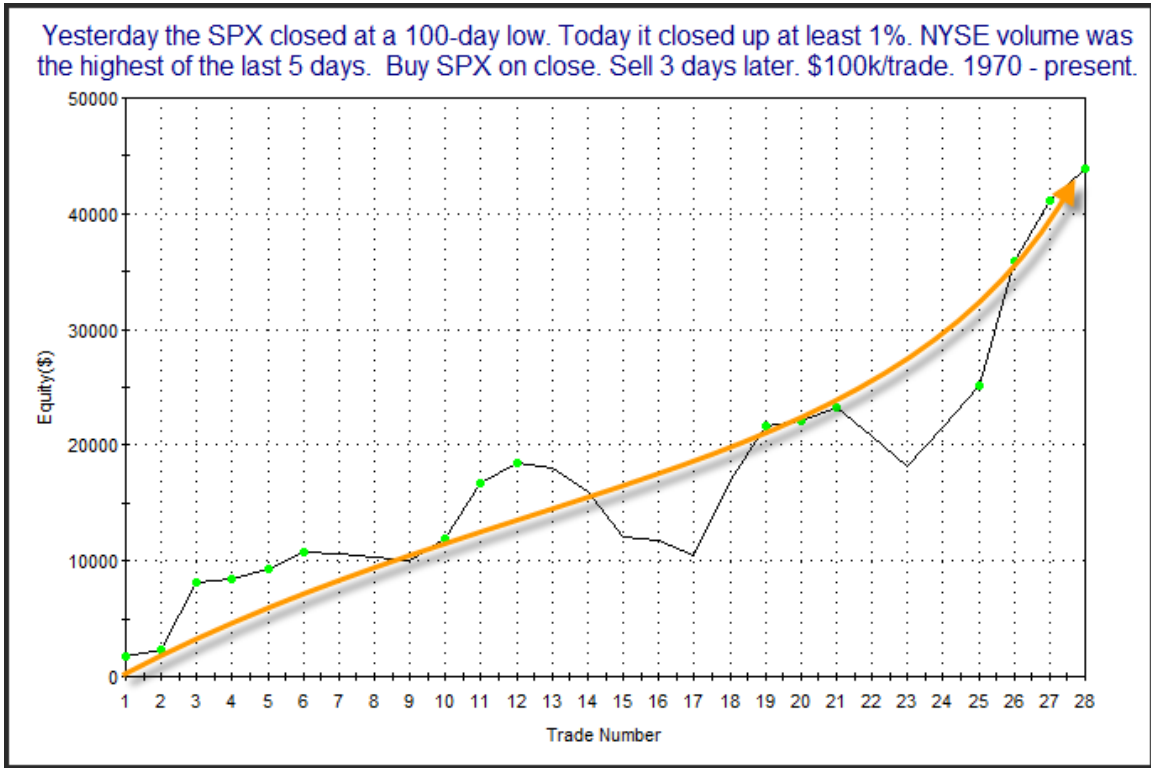
So the overdone move (5 lower lows) along with the new low seems to suggest an upside edge. What if we factored volume into the equation? The study below looks at other moves from 100-day lows where the bounce occurred on relatively high volume.

Yesterday the SPX closed at a 100-day low. Today it closed up at least 1%. NYSE volume was the highest of the last 5 days. Buy SPX on close. Sell X days later. \$100k/trade. 1970 - 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	47,809.29	25	16	9	64.00	4,364.85	-2,447.59	1.78	3.17	1,912.37
9	50,542.48	27	17	10	62.96	4,729.92	-2,986.62	1.58	2.69	1,871.94
8	46,647.34	27	18	9	66.67	3,975.67	-2,768.29	1.44	2.87	1,727.68
7	44,128.88	27	15	12	55.56	4,375.20	-1,791.60	2.44	3.05	1,634.40
6	33,212.74	28	17	11	60.71	3,569.04	-2,496.45	1.43	2.21	1,186.17
5	36,722.63	28	19	9	67.86	3,181.92	-2,637.09	1.21	2.55	1,311.52
4	37,621.45	28	18	10	64.29	3,206.41	-2,009.38	1.60	2.87	1,343.62
3	43,853.88	28	18	10	64.29	3,199.11	-1,373.01	2.33	4.19	1,566.21
2	21,149.25	30	17	13	56.67	2,304.63	-1,386.88	1.66	2.17	704.97
1	17,478.04	30	18	12	60.00	2,100.65	-1,694.47	1.24	1.86	582.60

27 of 30 instances (90%) closed above the entry price at some point in the next week.

Results here appear to suggest an upside edge. Below is an equity curve to see how the edge has played out over time.

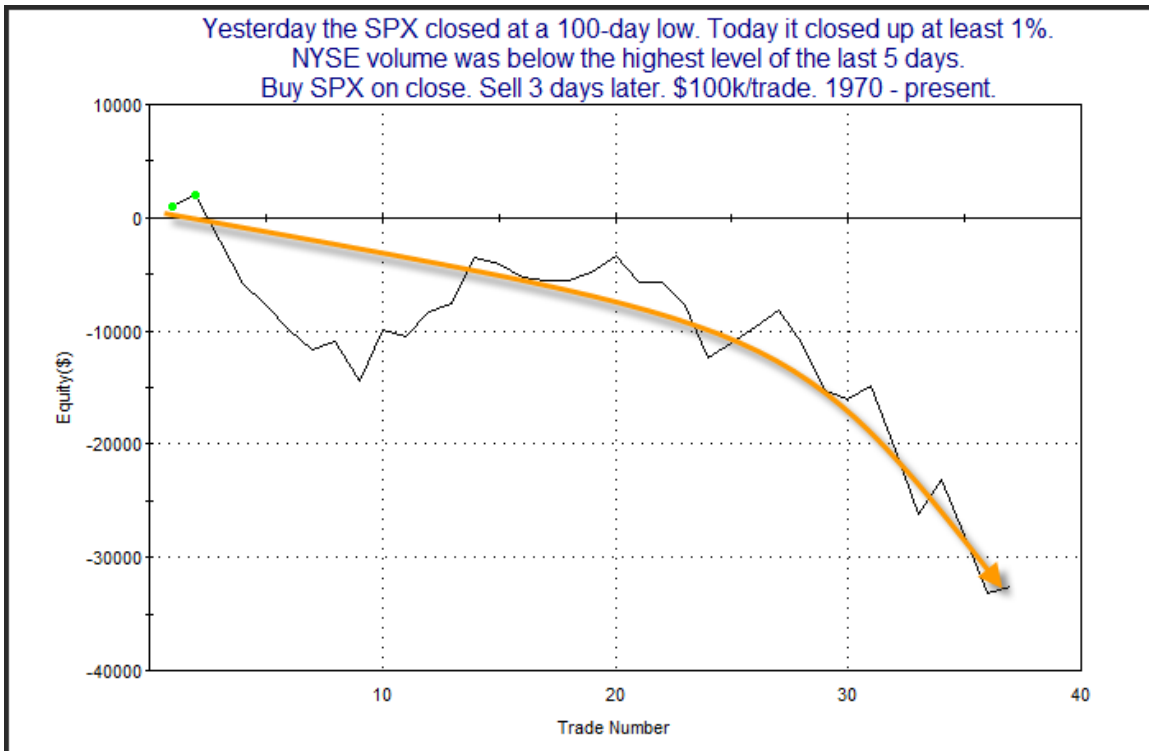


The strong upward slope confirms the edge suggested by the numbers. To isolate the impact of the volume let's now use the same criteria, but this time without the 5-day high in volume.

Yesterday the SPX closed at a 100-day low. Today it closed up at least 1%.
 NYSE volume was below the highest level of the last 5 days.
 Buy SPX on close. Sell 3 days later. \$100k/trade. 1970 - 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	-27,569.93	29	14	15	48.28	2,851.82	-4,499.70	0.63	0.59	-950.69
9	-29,717.45	31	16	15	51.61	3,307.50	-5,509.16	0.60	0.64	-958.63
8	-44,151.91	32	14	18	43.75	3,258.01	-4,986.89	0.65	0.51	-1,379.75
7	-34,994.88	32	15	17	46.88	3,316.12	-4,984.51	0.67	0.59	-1,093.59
6	-7,193.94	33	17	16	51.52	2,988.89	-3,625.31	0.82	0.88	-218.00
5	-4,823.07	33	16	17	48.48	3,137.38	-3,236.54	0.97	0.91	-146.15
4	-20,625.23	35	18	17	51.43	2,078.37	-3,413.88	0.61	0.64	-589.29
3	-32,646.29	37	15	21	40.54	1,686.30	-2,759.09	0.61	0.44	-882.33
2	-26,790.44	37	16	21	43.24	1,680.15	-2,555.85	0.66	0.50	-724.07
1	-11,239.55	37	14	23	37.84	1,025.85	-1,113.11	0.92	0.56	-303.77

The results primarily all flipped from positive to negative. A quick look at the equity curve below also shows that also appears to have flipped.



With tonight's studies now included, I have updated the [Aggregator](#) chart below.



Tonight's bullish studies have kept the green Aggregator line strongly positive. Levels above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line is also 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 strongly oversold versus recent expectations. Historically this combination has suggested an upside edge. The configuration can be seen on the chart whenever both lines close above 0. Due to this the Aggregator System remained long at the close.

At this point the green Aggregator line is poised to remain above 0 on Wednesday. The low number of studies allows for the potential to change if compelling bearish studies emerge. Meanwhile, the Differential Pivot will be 1,135.79. This is a little over 1% above Tuesday's close. So the SPX would need to close up at least this much in order for the Differential Line to turn negative.

It still appears there should be some bounce left in this move. With the big turnaround on Tuesday I am not inclined to pay up for new positions. I will maintain my current position unless Wednesday is so strong that the SPX closes above its' Differential Pivot.

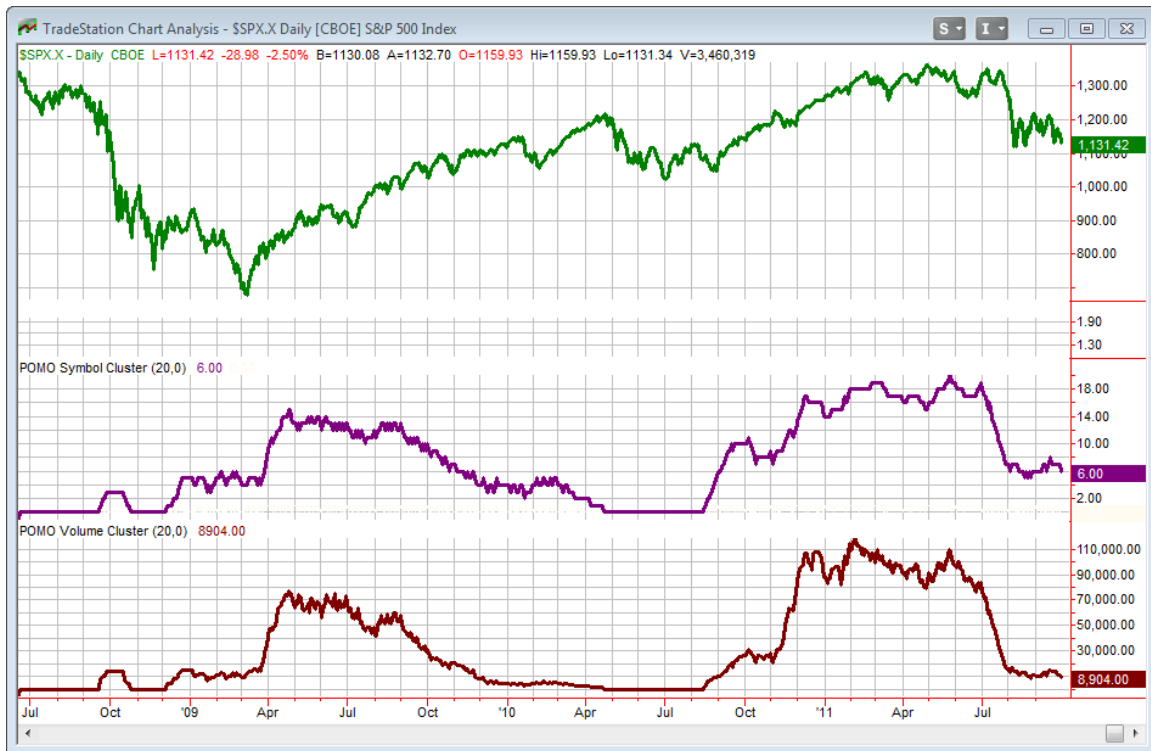
Intermediate-term Outlook (2 weeks – 2 months)– updated 10/3 – slightly bearish

The up and down action this past week left the SPX almost where it closed the week before. So while action was wild, neither bulls nor bears prevailed. From a studies standpoint nothing terribly compelling from an intermediate-term standpoint emerged.

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 dipped slightly this week. The purchase amounts over the last month are now a bit below 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. Since the end of QE2 it appears the very modest stimulus amount has failed to exert a positive effect, similar to the periods of 0 stimulus in recent years. I discussed “Operation Twist” in some detail last week. That may help some, but it hasn’t kicked in yet.

The market has traded in a wide range over the last 2 months. A break of that range in either direction could be a significant event. At this point we are not far from the bottom of the range, so we will see if it can hold. I don’t see myself getting bullish on the market until we see either a massive downside washout, or we are able to break some resistance levels and begin an uptrend. At this point that would require a move at least through the August highs. The SPX is not close to there yet. So it will continue to be conservative long-side plays and perhaps a little more aggressive on the short-side for me.

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.

None tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
APA(1/3)	9/23/2011	\$82.91	\$78.82	-4.93%		Catapult
APA(1/3)	9/26/2011	\$82.73	\$78.82	-4.73%		Catapult
SPY(1/4)	9/30/2011	\$114.45	\$112.34	-1.84%		Aggregator
SPY(1/4)	9/30/2011	\$112.49	\$112.34	-0.13%		Aggregator

I will look to sell 1 lot of SPY if SPX closes > 1,135.78.

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