

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 6, 2011

Volume 4 Issue 193

Market Overview



Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Flat	Flat	Flat	Long

Tonight's Research Points

- 2 strong up days during a down trend can sometimes suggest a downside edge, but not under current conditions.

Short-term Outlook

The Bottom Line

The bounce the last 2 days has been strong enough to move the market from short-term oversold to short-term overbought. I am out of most positions (and will get out of the rest at the open). It is now a matter of standing aside and waiting for the next favorable risk/reward opportunity to avail itself.

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	3.00%
October 5, 2011	5 lower lows. 50-day low. Up close.	1-4 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 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	

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

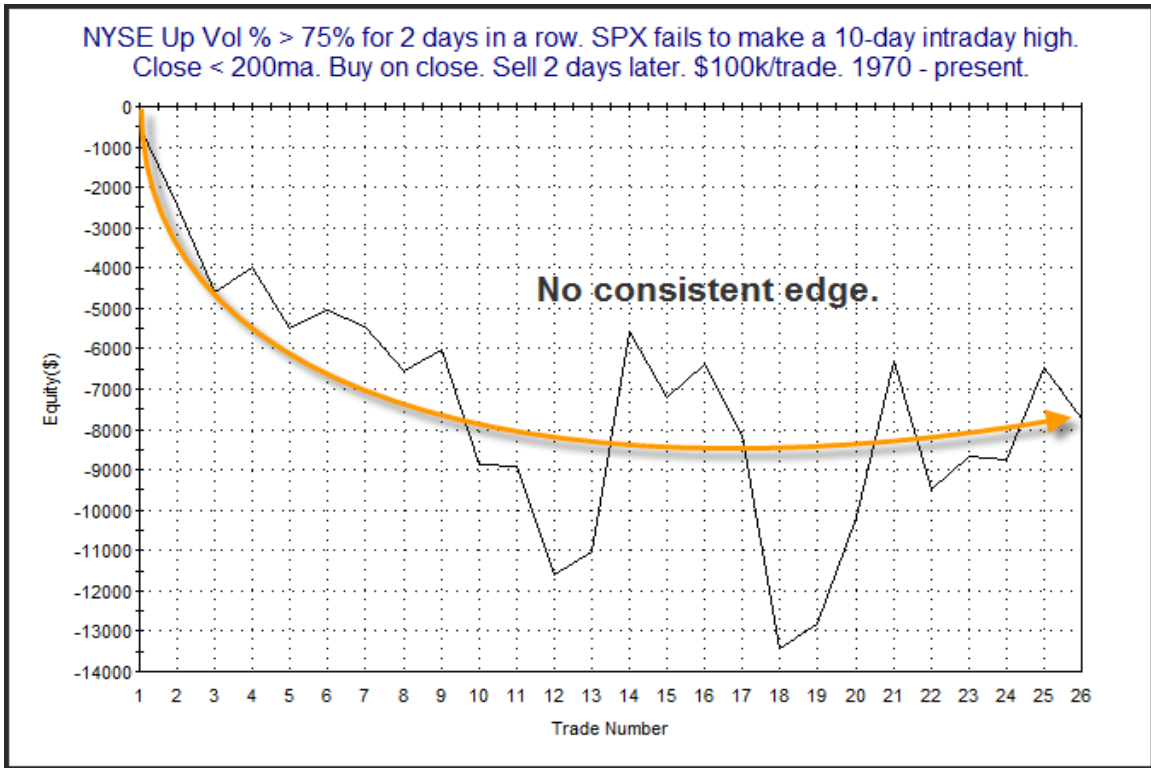
The Evidence

The reversal that began on Tuesday kept chugging on Wednesday. The major indices all closed strongly higher. The SPX finished up 1.8%, the Nasdaq rose 2.3%, and the Russell 2000 gained 1.4%. Breadth was strongly positive as the NYSE Up Issues % came in at 72% and the Up Volume % was 83.5%. Volume did not follow suit, though, and declined to the lowest level of the last 4 days.

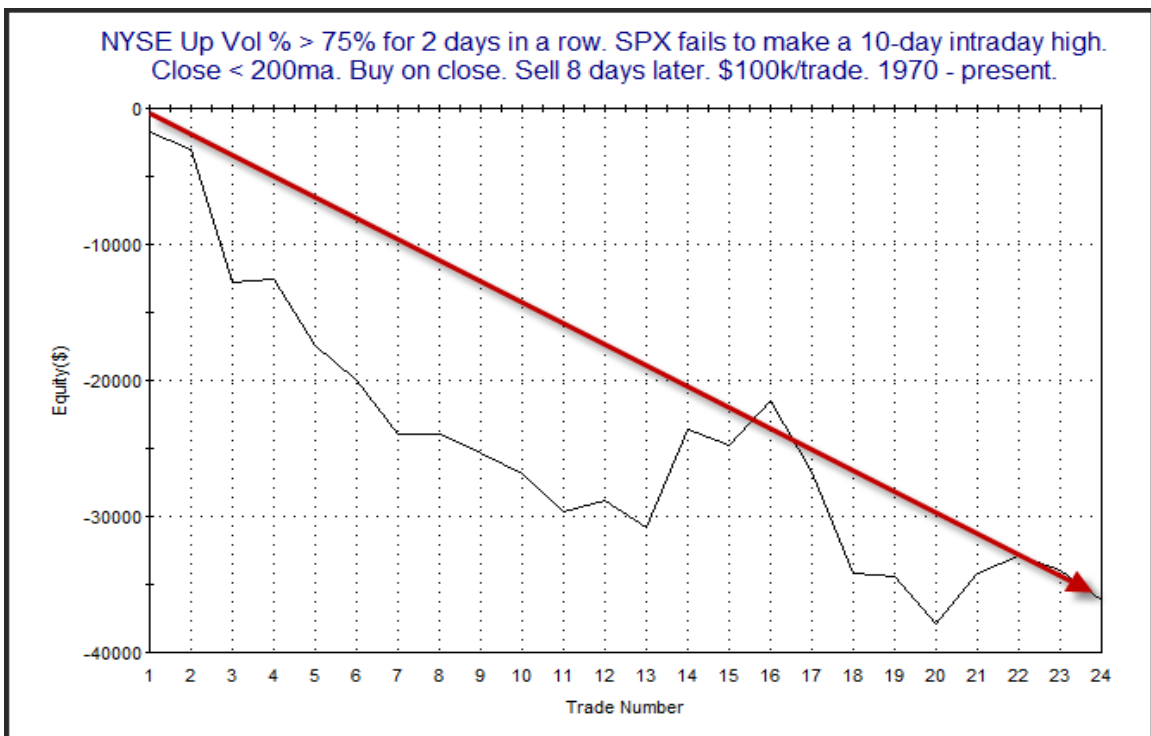
There were a few moderately bearish studies that appeared in the Quantifinder, but nothing of real consequence. The one below is from the 2/3/10 subscriber letter. It examines SPX performance following 2 strong breadth days when SPX is in a downtrend. I have updated the results below.

NYSE Up Vol % > 75% for 2 days in a row. SPX fails to make a 10-day intraday high. Close < 200ma. Buy 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	-32,649.14	24	9	15	37.50	2,962.97	-3,954.39	0.75	0.45	-1,360.38
9	-32,322.23	24	7	17	29.17	2,945.15	-3,114.02	0.95	0.39	-1,346.76
8	-36,109.45	24	7	17	29.17	2,355.55	-3,094.02	0.76	0.31	-1,504.56
7	-35,897.93	24	7	17	29.17	2,540.96	-3,157.92	0.80	0.33	-1,495.75
6	-32,105.73	25	9	16	36.00	2,416.45	-3,365.86	0.72	0.40	-1,284.23
5	-17,691.42	25	10	15	40.00	2,288.47	-2,705.08	0.85	0.56	-707.66
4	-15,479.82	25	11	14	44.00	1,781.87	-2,505.74	0.71	0.56	-619.19
3	-3,897.86	25	14	11	56.00	1,634.05	-2,434.05	0.67	0.85	-155.91
2	-7,725.39	26	11	15	42.31	1,697.16	-1,759.61	0.96	0.71	-297.13
1	-6,062.51	28	13	15	46.43	1,161.92	-1,411.16	0.82	0.71	-216.52

The first few days appear moderately bearish. After you get out a few days the downside edge appears to become more prevalent. In looking at the equity curves over various periods I found that there is no consistent edge over the first few days, but the 7-8 day period appears more reliable. Below are equity curves for the 2-day and 8-day holding periods.



As I mentioned, the 2-day hold shows no consistent edge. Next is the 8-day holding period.



This looks quite a bit better. While there is certainly some choppiness, the general direction remains down.

With the short-term results not showing significance this study is more something to keep in mind than something useful for generating expectations.

Another study that appeared looked at 2 strong days of price movement rather than breadth. It appeared to be losing some effectiveness, but more important than that it showed no real effectiveness when the 2-day rally immediately followed a 50-day low.

Now is a good time to remind subscribers that while sharp rallies in downtrends often generate good shorting opportunities, when the rally comes off a potential long-term bottom then shorting becomes quite a bit more dangerous. The risk of overbought becoming *extremely* overbought is much higher when the market is faced with the potential of a bottom being in place. Several of the studies will filter based on whether the market is emerging from a long-term bottom or not.

Another event I will be watching for is an IBD Follow Through Day (FTD). There is an awful lot that I have published on the blog with regards to FTDs. You can access that information by using the link below:

<http://quantifiableedges.blogspot.com/search/label/IBD%20Follow%20Through%20Day>

Investors' Business Daily touts FTDs as a tool for predicting new bull markets. I have not found them terribly useful in this regard. But I have found them useful. A FTD occurs when there is a strong thrust off of a potential bottom. By studying these events and using them as filters in some of the studies I look at we can often generate more meaningful results. So while they may not predict the next bull market on a reliable basis, their existence can be used to define the market environment. By better defining the market environment in this way we have a better chance of uncovering significant and quantifiable edges.

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



The green Aggregator line is still strongly positive. Very high readings tend to occur when there is no opposition – in this case no bearish studies. Levels above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line dropped sharply and is now below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are positive but the SPX is already overbought versus recent expectations. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. Due to this the Aggregator System switched from long to flat at the close.

At this point the green Aggregator line is poised to remain above 0 on Thursday. The low number of studies allows for the potential to change if compelling bearish studies emerge. Meanwhile, the Differential Pivot will be 1,110.30. This is nearly 3% below Wednesday's close. It is unlikely that such a drop will occur on Thursday. More likely is that it will take a few days for the overbought condition to wear off.

The strong breadth and price action in the last 2 days have moved the market from oversold to overbought. But while overbought conditions are now in place, there is not an indication of “overbought and likely to decline”. There is a difference between “overbought” and “overbought and likely to decline” and it equates to a neutral outlook instead of a bearish one. I’m stepping aside and am now in “wait and see” mode.

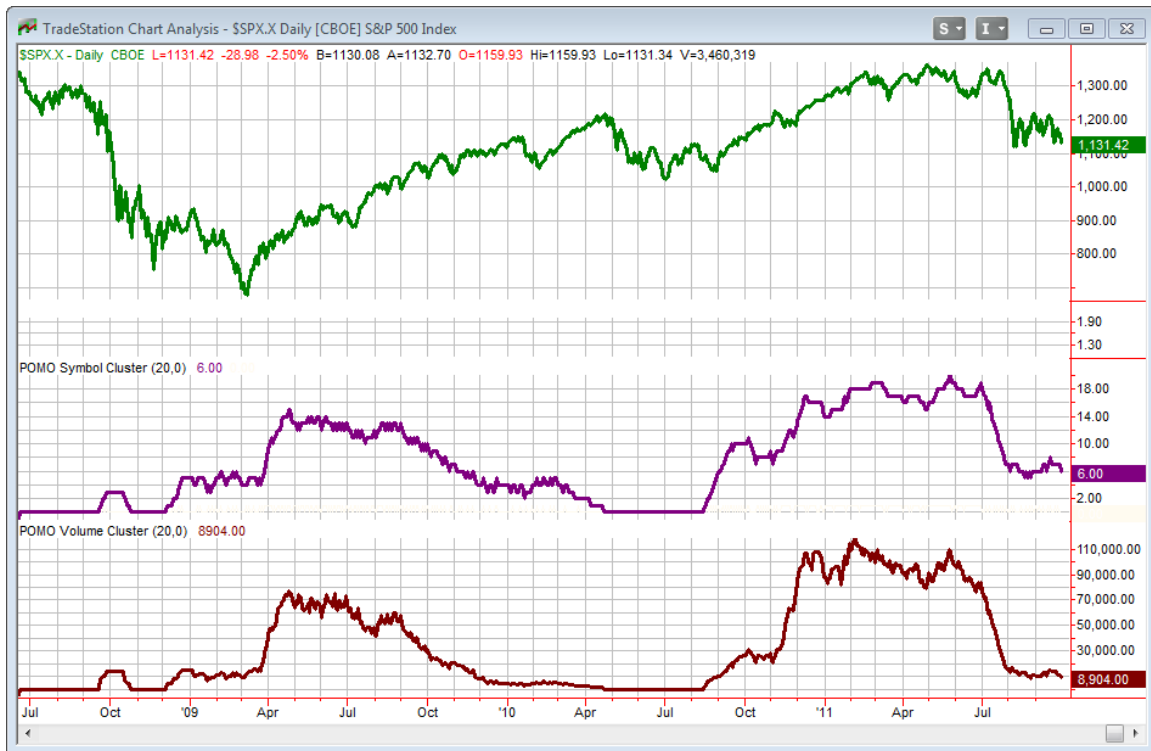
Intermediate-term Outlook (2 weeks – 2 months)– updated 10/3 – slightly bearish

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

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.

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	\$82.90	-0.01%		Sold on open
APA(1/3)	9/26/2011	\$82.73	\$82.90	0.21%		Sold on close
SPY(1/4)	9/30/2011	\$114.45	\$114.42	-0.03%		Sold on close
SPY(1/4)	10/3/2011	\$112.49	\$114.42	1.72%		Sold on close

As per the intraday updates sent to gold subscribers in the afternoon, both lots of SPY and 1 lot of APA were sold at the close. The remaining lot of APA will be exited at the open.

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