

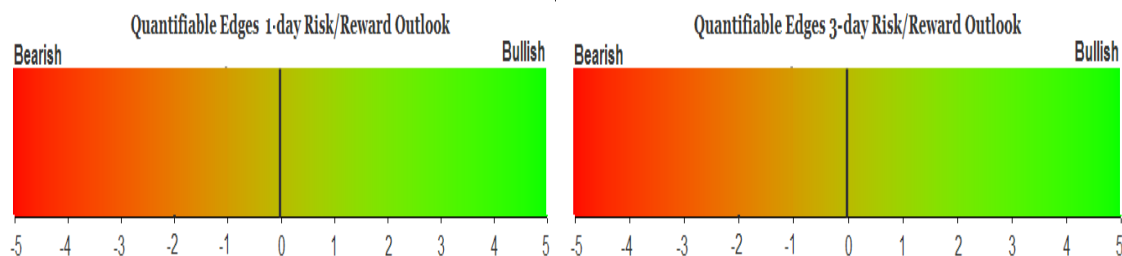
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 7, 2011

Volume 4 Issue 194

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- 3 days up from a 50-day low is often followed by more rallying.
- The low 3/10 Offset HV combined with the short-term overbought condition in a long-term downtrend is warning of a possible sharp drop.
- Strong breadth on the 3<sup>rd</sup> day of a rally is a good intermediate-term omen.

## Short-term Outlook

### The Bottom Line

While the market is extremely overbought short-term there still does not appear to be a decided downside edge. I'm still sidelined awaiting the next favorable setup.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
October 7, 2011	3/10 offset hv < 0.25. RSI(3) > 70.	1-3 days	Bearish	
October 7, 2011	3 up from 50-day low.	1-2 days	Bullish	
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	
<b>Active - Long Term</b>				
October 7, 2011	90% Up Volume on 3rd day up.	1-14 days	Bullish	
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%

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

### *The Evidence*

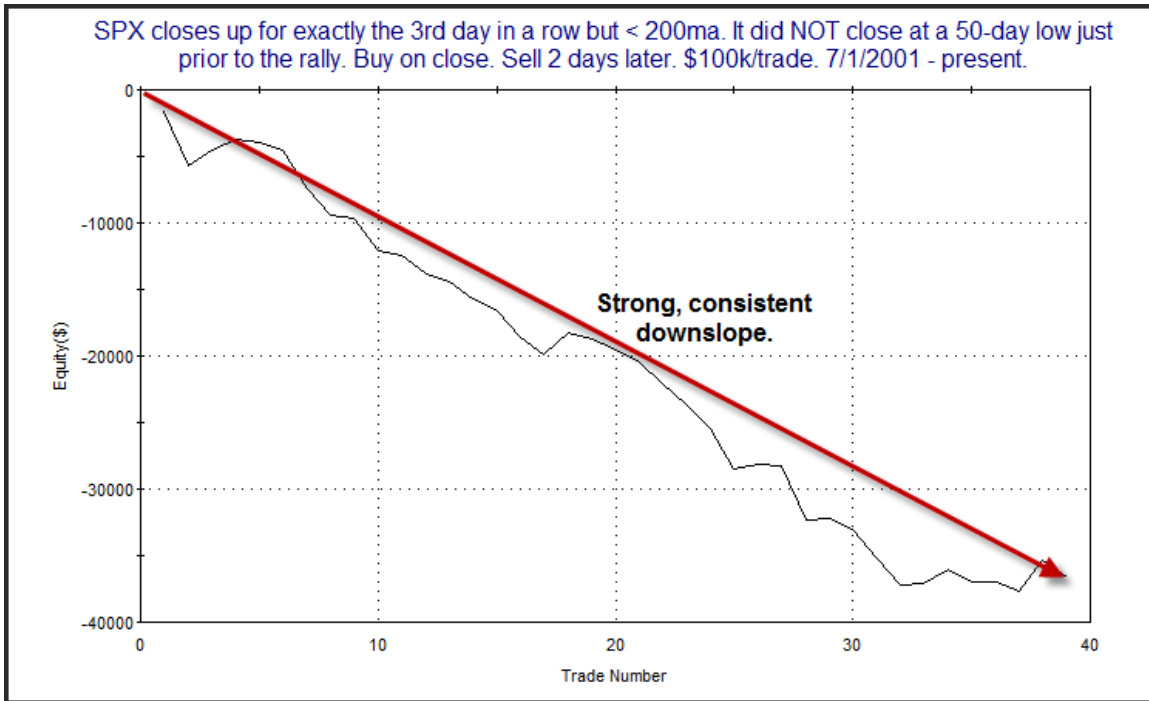
All of the stock market's worries appear to have been wiped away on Tuesday at around 3pm. Since then, aside from some brief pauses, it has done nothing but rally. Thursday marked the 3<sup>rd</sup> strong performance in a row. The SPX finished up 1.8%, the Nasdaq rose 1.9%, and the Russell 2000 gained 2.4%. Breadth was extremely strong as the NYSE Up Issues % came in at 84% and the Up Volume % was 93%. Total NYSE volume dipped for the 2<sup>nd</sup> day in a row.

I mentioned last night that though the market was beginning to get short-term overbought, the fact that we are in the midst of an initial bounce off an intermediate-term low makes shorting a dangerous proposal. You can see a number of examples of this in the Quantifinder tonight. Many studies looked at the 3-day rally in a downtrend and suggested a downside edge. But any of those that also filtered to search for thrusts from 50-day lows indicated no bearish edge. The difference between the bottom-thrust instances and those not initiated from a new low has become more pronounced in recent years. Whereas a strong move off a bottom might suggest no short-term directional edge in the past, it now appears to favor a further rally. With little need to get specific, let's look at a simple 3-day rally in a downtrend. I won't use any additional filters other than the 50-day low. First let's look at times the rally did not originate from a 50-day low:

SPX closes up for exactly the 3rd day in a row but < 200ma. It did NOT close at a 50-day low just prior to the rally. Buy on close. Sell X days later. \$100k/trade. 7/1/2001 - 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	-47,997.80	36	15	21	41.67	1,399.75	-3,285.43	0.43	0.30	-1,333.27
4	-63,038.80	39	13	26	33.33	1,143.02	-2,996.08	0.38	0.19	-1,616.38
3	-64,122.70	39	10	29	25.64	972.47	-2,546.46	0.38	0.13	-1,644.17
2	-36,677.02	39	8	31	20.51	939.97	-1,425.70	0.66	0.17	-940.44
1	-19,228.61	39	15	24	38.46	1,032.43	-1,446.46	0.71	0.45	-493.04

**34 of 39 instances (87%) posted a close below the entry price at some point in the next 3 days.**

Results here appear solidly bearish. Below is an equity curve that assumes a 2-day holding period.



The strong, consistent downslope is very impressive and serves to confirm the downside edge.

But next let's look at times like the present where the market is emerging from an intermediate-term low.

SPX closes up for exactly the 3rd day in a row but < 200ma. It closed at a 50-day low just prior to the rally. Buy on close. Sell X days later. \$100k/trade. 7/1/2001 - 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	27,434.70	11	9	2	81.82	3,270.97	-1,002.01	3.26	14.69	2,494.06
4	20,145.34	11	8	3	72.73	2,742.72	-598.80	4.58	12.21	1,831.39
3	15,590.37	11	8	3	72.73	2,613.14	-1,771.57	1.48	3.93	1,417.31
2	17,439.02	11	11	0	100.00	1,585.37	0.00	100.00	100.00	1,585.37
1	15,166.61	11	8	3	72.73	1,921.72	-69.05	27.83	74.22	1,378.78

**Prior to 2001 the setup did not appear to suggest any edge.**

These results appear to be a polar opposite of the previous set. It has been quite a hot streak since 2001 with these setups. Prior to that no edge was evident in either direction. I also decided to list below all instances assuming a 2-day exit strategy.

SPX closes up for exactly the 3rd day in a row but < 200ma.  
 It closed at a 50-day low just prior to the rally.  
 Buy on close. Sell X days later. \$100k/trade. 7/1/2001 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
07/27/01	Buy	\$1,205.82	0.45%	\$1,387.44
07/31/01	Sell	\$1,211.23		(\$443.62)
10/14/02	Buy	\$841.44	2.21%	\$4,699.94
10/16/02	Sell	\$860.02		\$0.00
01/02/03	Buy	\$909.03	2.20%	\$2,501.40
01/06/03	Sell	\$929.01		(\$655.60)
03/14/03	Buy	\$833.27	3.98%	\$4,040.40
03/18/03	Sell	\$866.45		(\$732.00)
07/29/04	Buy	\$1,100.43	0.56%	\$735.30
08/02/04	Sell	\$1,106.62		(\$312.30)
08/17/04	Buy	\$1,081.71	0.88%	\$1,238.32
08/19/04	Sell	\$1,091.23		(\$255.76)
11/29/07	Buy	\$1,469.72	0.18%	\$1,306.96
12/03/07	Sell	\$1,472.41		\$0.00
07/18/08	Buy	\$1,260.66	1.30%	\$1,324.04
07/22/08	Sell	\$1,277.01		(\$934.57)
11/25/08	Buy	\$857.39	4.53%	\$4,507.76
11/28/08	Sell	\$896.24		(\$1,858.32)
03/12/09	Buy	\$750.74	0.42%	\$3,164.07
03/16/09	Sell	\$753.89		(\$1,101.24)
07/08/10	Buy	\$1,070.25	0.79%	\$979.29
07/12/10	Sell	\$1,078.75		(\$199.95)

 **Circled instances are those that saw volume decline the last 2 days.**

There were some studies in the Quantifinder that suggested the decline in volume over the past 2 days may be a concern. In relation to this particular study, that does not appear to be the case. There were 4 such instances of 2 days of declining volume. They are all circled above.

One indicator that is providing a notable reading is the 3/10 Offset HV for the SPX. I first introduced this indicator in [the 7/13/2009 blog](#). It looks for periods where short-term historical volatility is contracting sharply. When that happens there is often a volatility expansion. This volatility expansion can occur in either direction. The indicator does not predict direction. But when combined with other indicators it can provide some powerful signals. The study below was last published in the 9/13/10 subscriber letter. I have updated all stats.

SPX 3/10 Offset HV < 0.25 and RSI(3) > 70. Close < 200ma. Buy on close. Sell X days later. \$100k/trade. 2000 - 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	-37,304.80	25	9	16	36.00	1,551.73	-3,204.40	0.48	0.27	-1,492.19
4	-33,879.99	26	8	18	30.77	1,122.50	-2,381.11	0.47	0.21	-1,303.08
3	-36,518.27	26	7	19	26.92	1,048.26	-2,308.21	0.45	0.17	-1,404.55
2	-24,425.11	28	7	21	25.00	1,018.34	-1,502.55	0.68	0.23	-872.33
1	-13,535.57	32	13	19	40.63	1,195.82	-1,530.59	0.78	0.53	-422.99

**89% of instances closed below the entry price at some point in the next 4 days.**

The 3-period RSI being over 70 suggests the market is at least moderately overbought short-term. Combining the short-term overbought condition with the long-term downtrend and the possibility of a volatility spike appears to yield some powerful results. Of course this doesn't factor in that the market is emerging from a 50-day low. So I decided to add that filter to see how that smaller set of results would look.

SPX 3/10 Offset HV < 0.25 and RSI(3) > 70. Close < 200ma. It is in the midst of an upthrust from a 50-day low. Buy on close. Sell X days later. \$100k/trade. 2000 - 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	-17,651.85	6	0	6	0.00	0.00	-2,941.97	0.00	0.00	-2,941.97
4	-16,588.41	6	0	6	0.00	0.00	-2,764.74	0.00	0.00	-2,764.74
3	-9,115.99	6	2	4	33.33	1,309.16	-2,933.58	0.45	0.22	-1,519.33
2	-11,813.94	6	1	5	16.67	1,510.64	-2,664.92	0.57	0.11	-1,968.99
1	-6,480.24	6	3	3	50.00	1,346.62	-3,506.70	0.38	0.38	-1,080.04

Results here are even more bearish. This is one of the few studies I have seen where the proximity to the 50-day low does not impact the results in favor of the bulls. I have listed all 6 instances below

SPX 3/10 Offset HV < 0.25 and RSI(3) > 70. Close < 200ma.  
 It is in the midst of an upthrust from a 50-day low.  
 Buy on close. Sell 5 days later. \$100k/trade. 2000 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
12/28/00	Buy	\$1,334.19	(2.68%)	\$1,187.70
01/05/01	Sell	\$1,298.47		(\$4,408.18)
03/07/01	Buy	\$1,261.89	(7.54%)	\$364.19
03/14/01	Sell	\$1,166.71		(\$8,416.66)
03/20/03	Buy	\$875.84	(0.84%)	\$2,286.84
03/27/03	Sell	\$868.52		(\$2,023.50)
08/02/04	Buy	\$1,106.62	(3.74%)	\$0.00
08/09/04	Sell	\$1,065.22		(\$3,995.10)
11/28/08	Buy	\$896.24	(2.25%)	\$0.00
12/05/08	Sell	\$876.07		(\$8,941.05)
07/12/10	Buy	\$1,078.75	(0.70%)	\$1,905.32
07/19/10	Sell	\$1,071.25		(\$1,622.88)

**While the max runup was 2.3% and the average runup was 0.95%, the average drawdown was 4.9%.**

As you can see, risk/reward appears to heavily favor the bears.

There was one other study that appeared tonight that I felt was worth reviewing. The extremely strong breadth occurring after there has already been a rally of a few days will often help to kick off a further move to the upside over the next 2-3 weeks. This can be seen in the study below, which last appeared in the 8/16/11 subscriber letter.

SPX closes higher for at least the 3rd day in a row and the NYSE Up Volume % > 90%.  
Buy on close. Sell X days later. \$100k/trade. 10/20/87 - 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
20	30,884.79	16	10	6	62.50	4,685.94	-2,662.43	1.76	2.93	1,930.30
19	24,295.23	16	11	5	68.75	3,713.93	-3,311.61	1.12	2.47	1,518.45
18	26,677.11	16	12	4	75.00	3,449.55	-3,679.38	0.94	2.81	1,667.32
17	32,076.57	16	11	5	68.75	4,024.64	-2,438.89	1.65	3.63	2,004.79
16	34,462.02	16	12	4	75.00	3,618.49	-2,239.97	1.62	4.85	2,153.88
15	33,166.10	17	12	5	70.59	3,668.62	-2,171.47	1.69	4.05	1,950.95
14	35,527.81	17	15	2	88.24	2,696.46	-2,459.53	1.10	8.22	2,089.87
13	28,604.70	18	14	4	77.78	2,345.57	-1,058.30	2.22	7.76	1,589.15
12	24,509.61	18	14	4	77.78	2,188.52	-1,532.42	1.43	5.00	1,361.64
11	23,145.77	18	11	7	61.11	2,534.41	-676.11	3.75	5.89	1,285.88
10	24,931.29	18	13	5	72.22	2,610.27	-1,800.43	1.45	3.77	1,385.07
9	21,787.14	18	13	5	72.22	2,259.75	-1,517.91	1.49	3.87	1,210.40
8	15,691.15	18	13	5	72.22	2,141.96	-2,430.86	0.88	2.29	871.73
7	20,988.83	18	12	6	66.67	2,446.42	-1,394.69	1.75	3.51	1,166.05
6	12,740.05	18	11	7	61.11	2,184.08	-1,612.11	1.35	2.13	707.78
5	8,101.47	18	13	5	72.22	1,796.47	-3,050.52	0.59	1.53	450.08
4	6,465.60	18	13	5	72.22	1,447.35	-2,470.00	0.59	1.52	359.20
3	-972.56	18	11	7	61.11	1,345.71	-2,253.63	0.60	0.94	-54.03
2	2,036.36	18	14	4	77.78	818.75	-2,356.54	0.35	1.22	113.13
1	6,232.88	18	9	9	50.00	961.74	-269.20	3.57	3.57	346.27

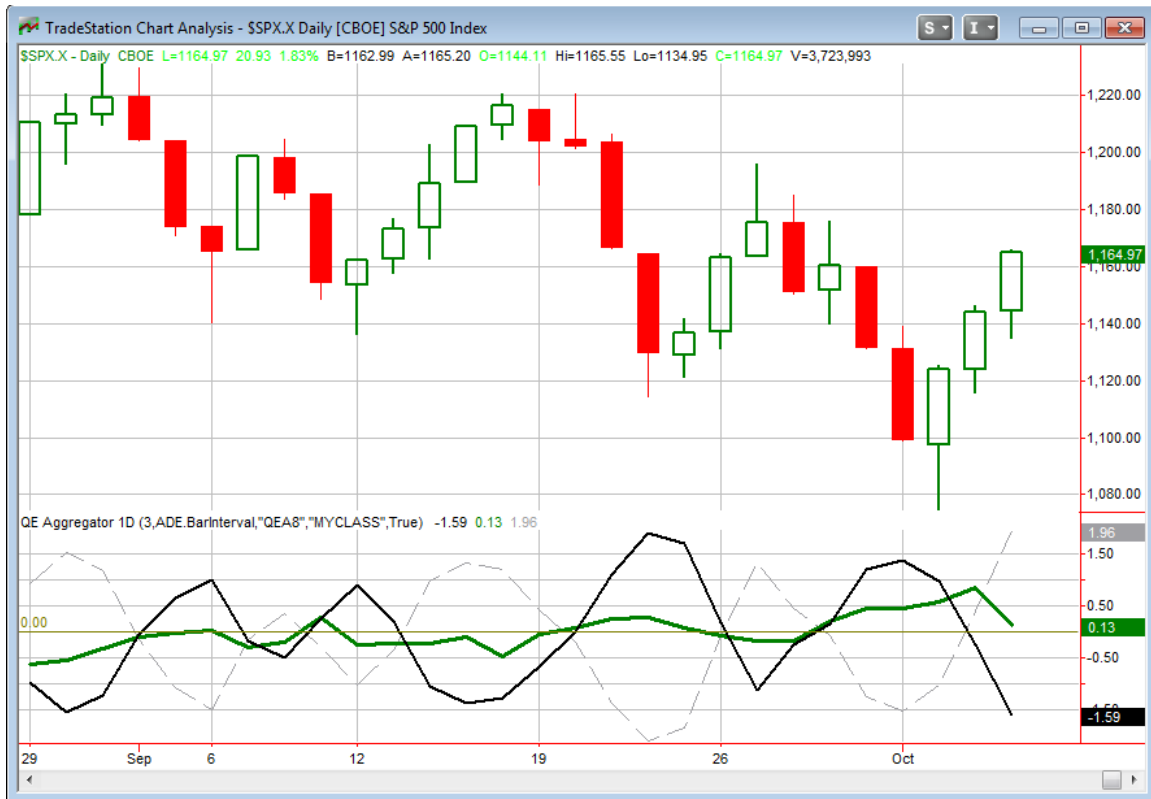
Results appear to strongly favor the bull case, especially over the 2-3 week timeframe. Below I have listed all instances assuming a 14-day holding period.

SPX closes higher for at least the 3rd day in a row and the NYSE Up Volume % > 90%. Buy on close. Sell 14 days later. \$100k/trade. 10/20/87 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
10/29/87	Buy	\$244.77	0.32%	\$5,071.44
11/18/87	Sell	\$245.55		(\$2,913.12)
05/12/89	Buy	\$313.84	3.72%	\$3,746.04
06/02/89	Sell	\$325.52		\$0.00
05/11/90	Buy	\$352.00	3.17%	\$3,271.68
06/01/90	Sell	\$363.15		(\$17.04)
01/02/03	Buy	\$909.03	(2.39%)	\$2,862.20
01/23/03	Sell	\$887.34		(\$3,535.40)
03/17/03	Buy	\$862.79	1.86%	\$3,807.65
04/04/03	Sell	\$878.85		(\$2,197.65)
03/21/07	Buy	\$1,435.04	0.27%	\$944.61
04/11/07	Sell	\$1,438.87		(\$1,803.66)
11/26/08	Buy	\$887.68	1.89%	\$3,491.04
12/17/08	Sell	\$904.42		(\$8,062.88)
03/12/09	Buy	\$750.74	8.04%	\$10,933.93
04/01/09	Sell	\$811.08		(\$1,101.24)
04/02/09	Buy	\$834.38	2.10%	\$4,908.75
04/23/09	Sell	\$851.92		(\$2,362.15)
07/15/09	Buy	\$932.68	7.82%	\$7,965.08
08/04/09	Sell	\$1,005.65		(\$559.61)
08/21/09	Buy	\$1,026.13	1.62%	\$2,138.85
09/11/09	Sell	\$1,042.73		(\$3,313.52)
11/09/09	Buy	\$1,093.08	0.23%	\$1,875.51
11/30/09	Sell	\$1,095.63		(\$849.94)
03/05/10	Buy	\$1,138.70	2.37%	\$3,653.13
03/25/10	Sell	\$1,165.73		(\$330.60)
07/13/10	Buy	\$1,095.34	2.79%	\$2,908.36
08/02/10	Sell	\$1,125.86		(\$3,499.86)
09/03/10	Buy	\$1,104.51	4.00%	\$3,995.10
09/24/10	Sell	\$1,148.67		(\$1,202.40)
07/01/11	Buy	\$1,339.67	0.40%	\$1,243.94
07/22/11	Sell	\$1,345.02		(\$3,237.50)
08/15/11	Buy	\$1,204.49	(2.53%)	\$2,176.26
09/02/11	Sell	\$1,173.97		(\$6,922.20)

The August instance was a loser, but there still appears to be a healthy upside edge.

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



The mix of studies tonight caused the green Aggregator line to dip a little, though it still maintained a positive reading. 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 far 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 strongly 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 remained flat at the close.

The green Aggregator line value on Friday will be highly dependent on what studies emerge. If no new studies trigger then we would see a very small negative reading. Meanwhile, the Differential Pivot will be 1,140.00. This is a little over 2% below Thursday's close. It is unlikely that such a drop will occur on Friday. More likely is that it will take a few days for the overbought condition to wear off.

I remain unconvinced by evidence favoring either the bulls or the bears. At this point a short signal would appear an easier task, and it could trigger if the SPX posts a 4<sup>th</sup> straight up day on Friday. But as I have discussed repeatedly, shorting into an initial rally off an intermediate-term bottom can be dangerous. So rather than try and aggressively

anticipate anything a night in advance, I will stand aside one more day and then evaluate further over the weekend before considering putting capital at risk.

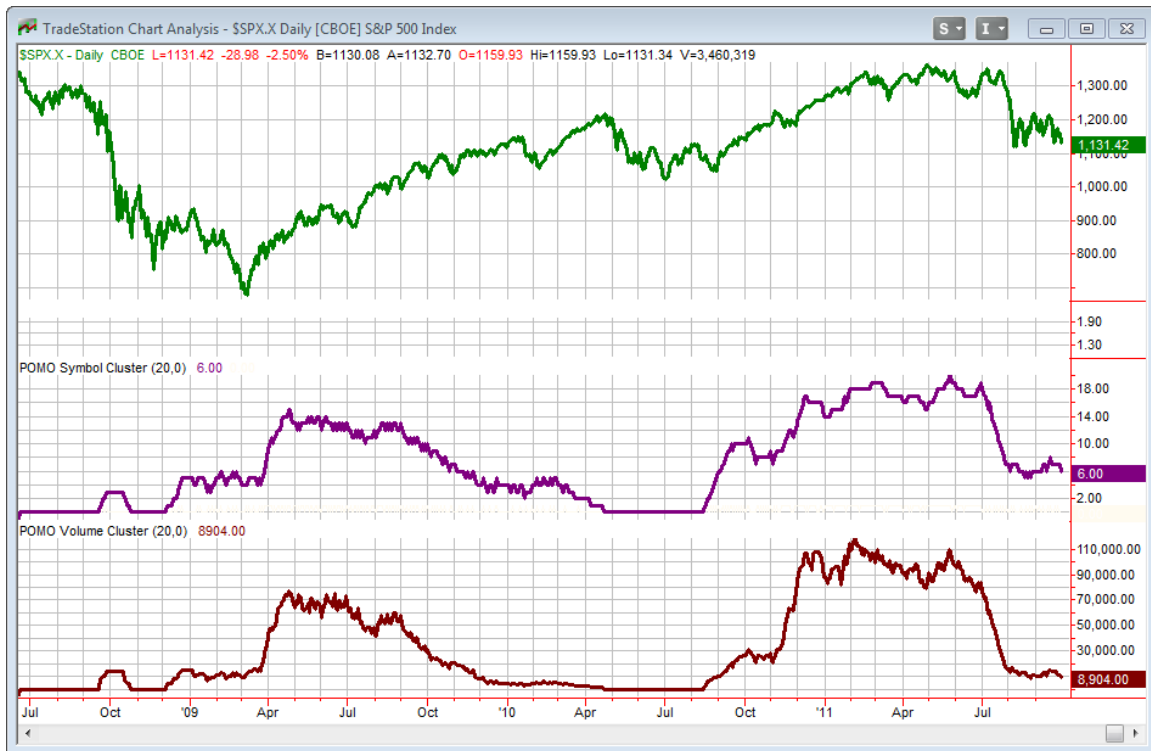
***Intermediate-term Outlook (2 weeks – 2 months)– updated 10/3 – slightly bearish***

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 3<sup>rd</sup> 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**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Price</b>	<b>% Gain/Loss</b>	<b>Stop</b>	<b>Notes</b>
<i>APA(1/3)</i>	<i>9/23/2011</i>	<i>\$82.91</i>	<i>\$83.20</i>	<i>0.35%</i>		<i>Sold on open</i>

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.