

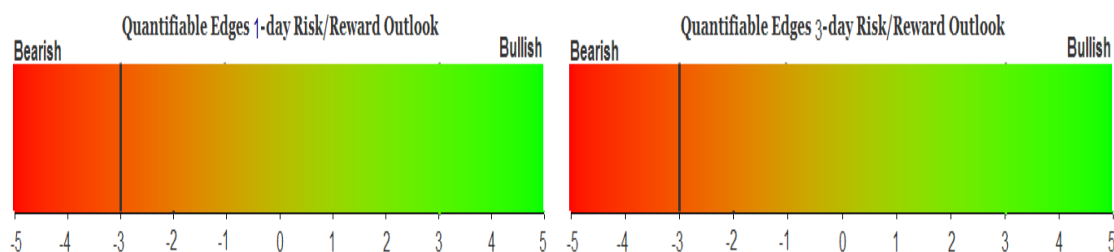
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 12, 2011

Volume 4 Issue 197

Market Overview



Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Short	75% Long VXX	100% Short SPY	Flat

Tonight's Research Points

- 5 higher highs under similar circumstances in the past has often been followed by a pullback.
- Low range and volume in SPY when short-term overbought in a downtrend has typically provided solid short opportunities.

Short-term Outlook

The Bottom Line

I continue to see indications suggesting a pullback is likely. I am currently short and looking to up my short exposure further on Wednesday.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
October 12, 2011	Low vol & range 20. Close > 10ma < 200	1-2 days	Bearish	-2.40%
October 12, 2011	5 higher highs no 20-day high	1-4 days	Bearish	-2.25%
October 11, 2011	SPY gap-n-go to new 10-day high < 200	1-3 days	Bearish	-2.90%
October 11, 2011	VXO > 15% below 10ma.	1-3 days	Bearish	-3.60%
Active - Long Term				
October 11, 2011	2nd 90% up vol in a week	1-14 days	Bullish	
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%
Dropped Tonight				
October 7, 2011	3/10 offset hv < 0.25. RSI(3) > 70.	1-3 days	Bearish	

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

The Evidence

A tight range on Tuesday ended with mild gains. The SPX rose less than 0.1%, the Nasdaq rallied 0.7%, and the Russell 2000 gained 0.6%. Breadth was moderately positive as the NYSE Up Issues % came in at 56% and the Up Volume % was 58%. Total NYSE volume rose from Monday’s holiday trading, but just barely.

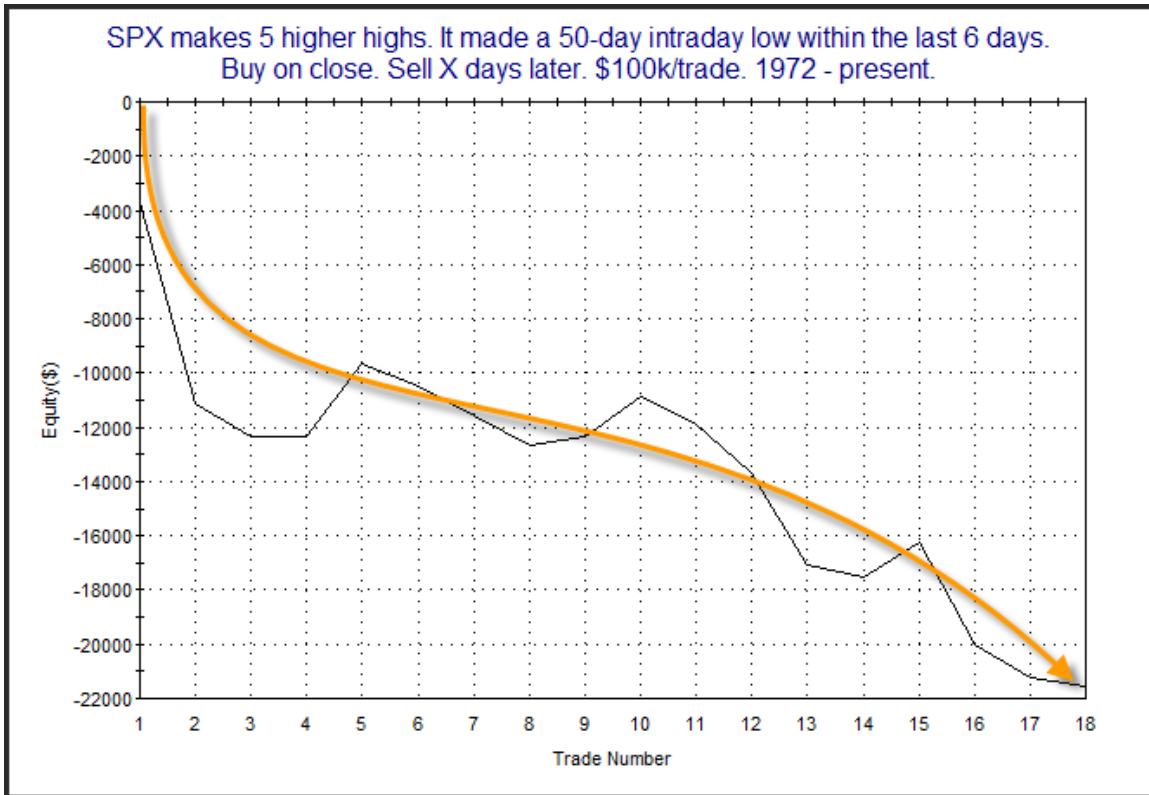
Tuesday marked the fifth day in a row that the S&P 500 made a higher high. Often after this occurs, the market will either pause or pullback. There were a few studies that looked at instances of five higher highs in the Quantifinder tonight.

This first one below was from the 5/19/08 subscriber letter. It looked for the pattern of 5 higher highs to emerge from a 50-day low. All statistics are updated.

SPX makes 5 higher highs. It made a 50-day intraday low within the last 6 days. Buy on close. Sell X days later. \$100k/trade. 1972 - 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	-21,552.42	18	5	13	27.78	1,148.08	-2,099.45	0.55	0.21	-1,197.36
4	-14,564.35	18	6	12	33.33	1,108.48	-1,767.94	0.63	0.31	-809.13
3	-15,379.78	18	7	11	38.89	885.23	-1,961.49	0.45	0.29	-854.43
2	-4,865.90	18	8	10	44.44	1,313.47	-1,537.37	0.85	0.68	-270.33
1	-3,144.27	18	8	10	44.44	613.34	-805.10	0.76	0.61	-174.68

16 of 18 instances (89%) closed below the entry price at some point in the next 4 days. The 2 that didn't occurred on 1/9/77 and 3/31/04.

The stats table suggests a downside edge. Below is an equity curve assuming a 5-day holding period.



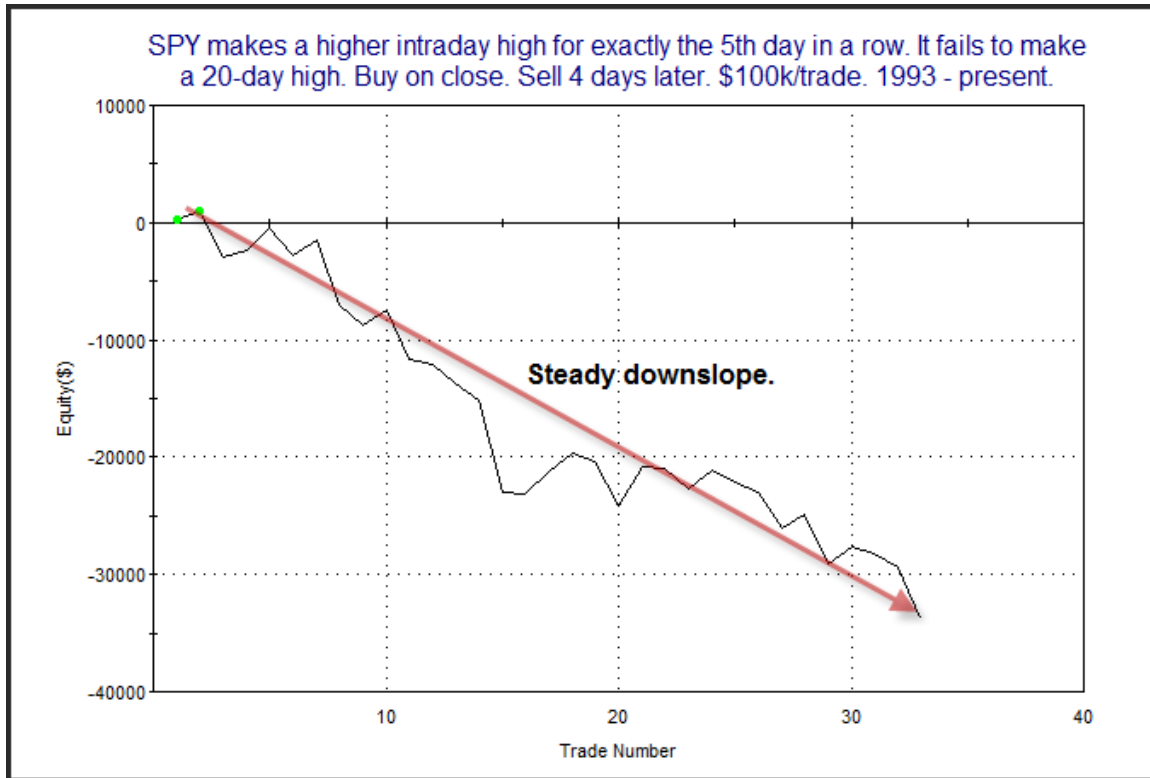
The curve is a little choppy and inconsistent, but a down slope persists throughout. While perhaps not ideal, it appears worthy of consideration.

This next study also examines situations with five higher highs. It was last updated in the 7/1/09 subscriber letter. Instead of requiring a 50-day low it simply looks for times that the five higher highs failed to register a 20-day high. Instead of using SPX I switched the study to use SPY. I did this because SPY generally reflects highs and lows more accurately. All statistics are updated.

SPY makes a higher intraday high for exactly the 5th day in a row. It fails to make a 20-day high.
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	-23,433.70	33	14	19	42.42	1,763.27	-2,532.60	0.70	0.51	-710.11
4	-33,789.19	33	12	21	36.36	1,440.24	-2,432.00	0.59	0.34	-1,023.91
3	-15,425.92	33	16	17	48.48	1,280.63	-2,112.71	0.61	0.57	-467.45
2	-4,151.07	33	14	19	42.42	1,264.69	-1,150.36	1.10	0.81	-125.79
1	-2,277.58	33	16	17	48.48	667.89	-762.57	0.88	0.82	-69.02

Here again we see what appears to be a substantial downside edge. The profit curve using a 4-day exit strategy can be found below.



I prefer this study to the first one. There are a greater number of instances, the equity curve is smoother, instances are more recent, and it uses SPY instead of SPX. Therefore I have decided to use this study for estimates.

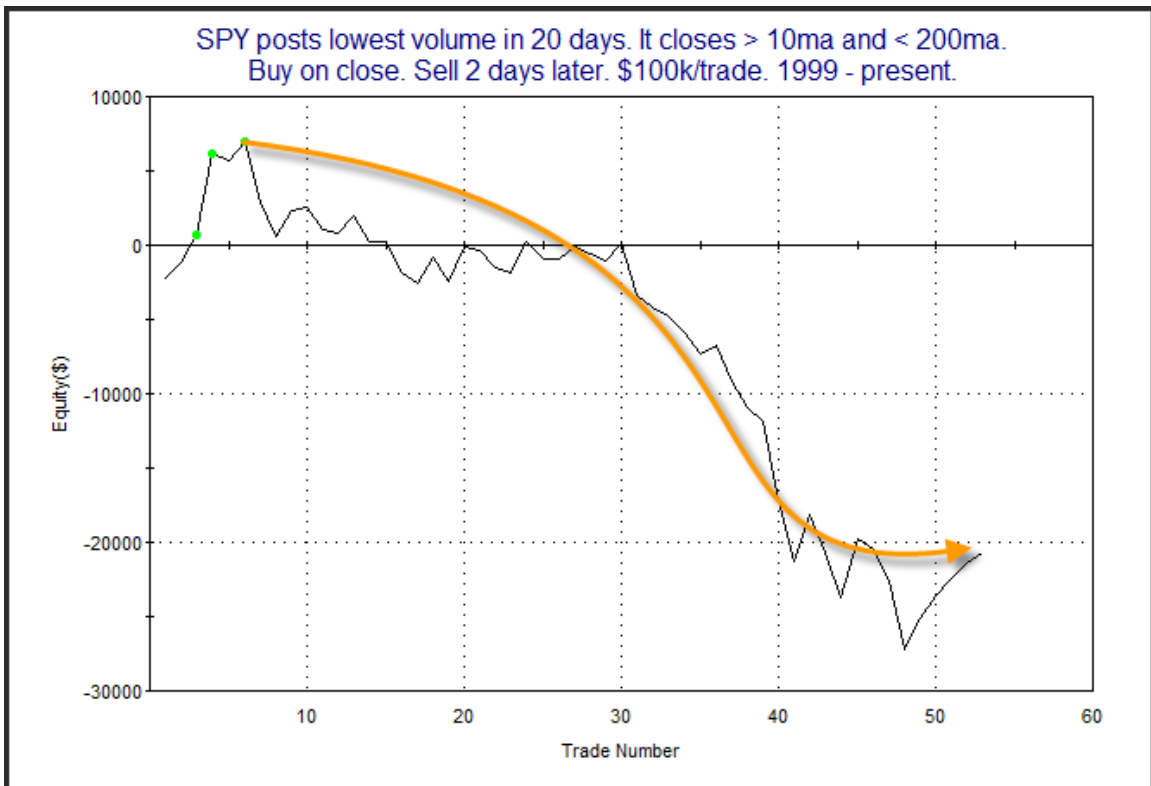
While NYSE volume came in slightly higher than Monday, SPY volume did not. Columbus Day provided a good excuse for the lack of volume Monday. There was no such excuse on Tuesday. Frequently, very low SPY volume is a sign of complacency and is followed by a market dip. Another negative from Tuesday's action is the extremely tight range. Not only was volume the lowest in 20 days, but SPY's range was also the lowest in 20 days. Low range days during a downtrend can be another sign suggesting short-term weaknesses is ahead. There were a few studies in the Quantifinder that demonstrated these concepts. I went off the board and created a few new ones in an effort to demonstrate these ideas in a more straightforward manner.

This first study simply considers low-volume days that occur when SPY is trading above its 10ma and below its 200ma.

SPY posts lowest volume in 20 days. It closes > 10ma and < 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
5	-38,584.96	45	17	28	37.78	2,236.82	-2,736.10	0.82	0.50	-857.44
4	-20,708.58	47	24	23	51.06	1,770.71	-2,748.07	0.64	0.67	-440.61
3	-15,717.06	50	19	31	38.00	2,100.39	-1,794.34	1.17	0.72	-314.34
2	-20,649.60	53	21	32	39.62	1,677.18	-1,745.95	0.96	0.63	-389.62
1	-23,940.22	62	26	36	41.94	1,207.95	-1,537.41	0.79	0.57	-386.13

Stats here suggest a possible downside edge. Below is an equity curve that assumes a 2-day holding period.



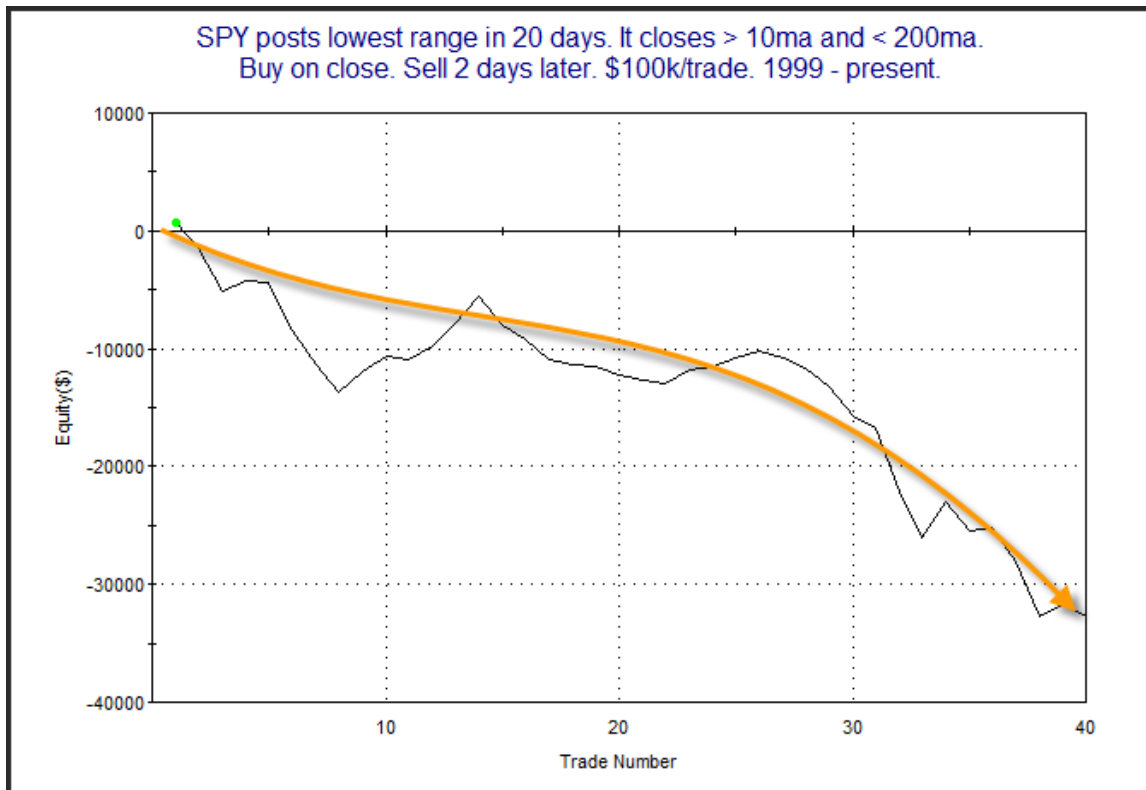
Not the straightest line, but still suggestive of a possible downside edge.

Next I took the same test and substituted a 20-day low range for the 20-day low volume.

SPY posts lowest range in 20 days. It closes > 10ma and < 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
5	-33,000.92	34	14	20	41.18	1,609.69	-2,776.83	0.58	0.41	-970.62
4	-34,276.32	36	15	21	41.67	1,344.31	-2,592.42	0.52	0.37	-952.12
3	-24,524.71	37	16	21	43.24	1,584.47	-2,375.06	0.67	0.51	-662.83
2	-32,789.48	40	14	26	35.00	1,241.86	-1,929.83	0.64	0.35	-819.74
1	-20,176.55	42	18	24	42.86	1,093.19	-1,660.58	0.66	0.49	-480.39

Here again we see a possible downside edge. The statistics appear even a bit more impressive than the volume-related test. Below is the profit curve assuming a 2-day exit strategy.



This curve is a bit smoother and appears to suggest a downside edge.

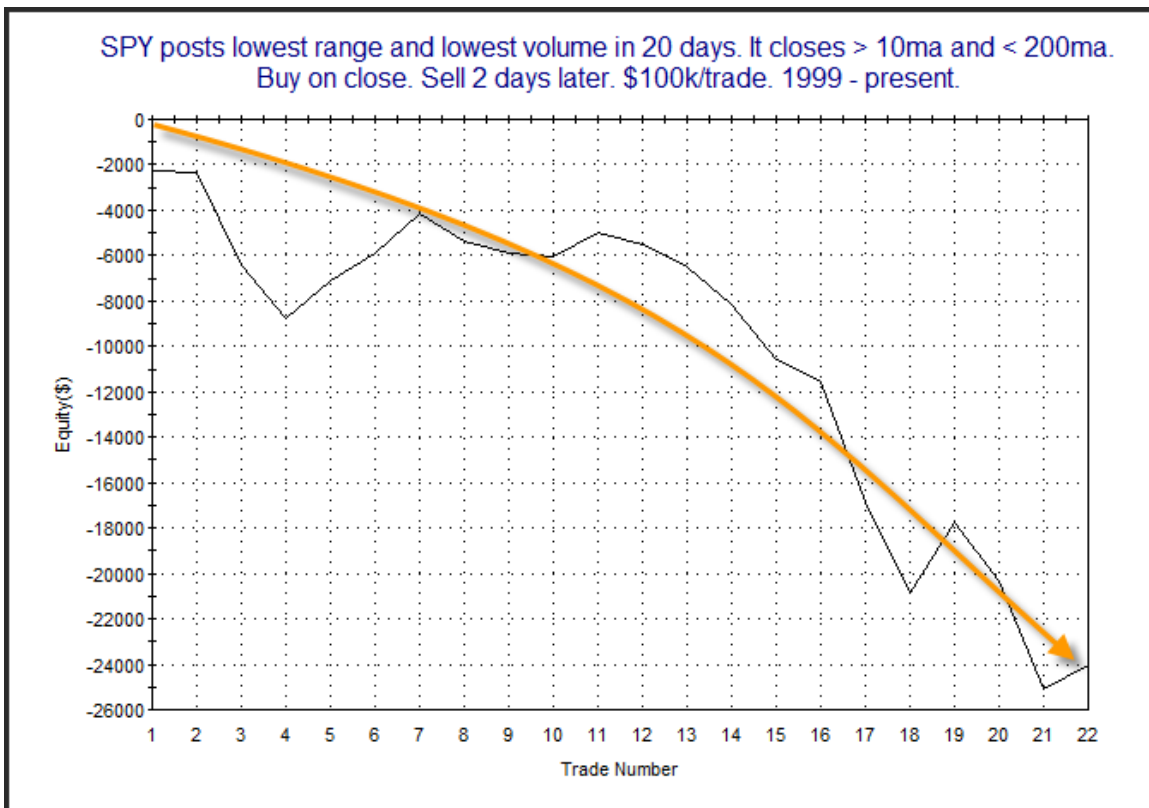
Now let's look at what happens when both volume and range come in extremely low.

**SPY posts lowest range and lowest volume in 20 days. It closes > 10ma and < 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
5	-29,378.51	21	7	14	33.33	1,987.51	-3,092.22	0.64	0.32	-1,398.98
4	-30,743.60	21	8	13	38.10	1,512.00	-3,295.35	0.46	0.28	-1,463.98
3	-22,087.82	22	9	13	40.91	1,718.63	-2,888.89	0.59	0.41	-1,003.99
2	-24,006.86	22	6	16	27.27	1,643.28	-2,116.66	0.78	0.29	-1,091.22
1	-22,085.09	22	7	15	31.82	1,272.22	-2,066.04	0.62	0.29	-1,003.87

**95% of instances closed below the entry price at some point in the next week.
The only 1 that didn't was the most recent, which occurred on 9/10/10.**

The numbers here appear even more impressive. Especially compelling is the fact that only one instance failed to close below the entry price at some point in the next week. And again below I have generated an equity curve assuming a 2-day holding period.



Once again we see a persistent downslope, which appears to confirm the bearish edge.

Of course SPY didn't merely close above its 10ma, it closed at a 10-day high. So let's take a quick look at what happened when this was the case.

SPY posts lowest range and lowest volume in 20 days. It closes at a 10-day high and < 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
5	-12,767.57	7	3	4	42.86	1,032.39	-3,966.18	0.26	0.20	-1,823.94
4	-14,583.95	7	3	4	42.86	984.12	-4,384.08	0.22	0.17	-2,083.42
3	-11,994.76	7	3	4	42.86	837.01	-3,626.45	0.23	0.17	-1,713.54
2	-10,165.13	7	1	6	14.29	1,049.49	-1,869.10	0.56	0.09	-1,452.16
1	-3,154.75	7	4	3	57.14	1,529.42	-3,090.82	0.49	0.66	-450.68

These are the strongest numbers of all, but of course the instances are too low to consider reliable. Still, any concern someone might have that the 10-day high would weaken the possible downside edge should be alleviated.

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



With the bearish studies tonight the green Aggregator line remains in negative territory. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the black Differential Line also remains 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 overbought versus recent expectations. Historically this combination has provided a bearish edge. Bearish configurations are visible on the chart whenever both lines close below 0. Due to this the Aggregator System stayed short at the close.

The short-term Active List still contains only bearish studies. Therefore the green Aggregator line is again set to close negative on Wednesday. It would take some very compelling bullish evidence in order for this to change. Meanwhile, the Differential Pivot will be 1,167.18. This is about 2.4% below Tuesday's close. So it would take a drop of at least this much in order to flip the Differential line positive. That would be a pretty large 1-day drop. A more likely scenario at this point is a multi-day pullback.

I was looking to get as many as 2 lots short on Tuesday. While I got a fill on the 1st one, I did not on the 2nd one. I will take a somewhat more Aggressive approach tomorrow with the 2nd lot and will look to enter it on a retest of Tuesday's high.

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

New lows were made this week but they were quickly followed by strong buying. The market is trying to carve out a bottom but to this point there have been few clues as to whether it will be successful. I suspect we will see more studies with intermediate-term implications this upcoming week.

There was one study that triggered on Thursday night with intermediate-term implications. 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

After a brief consolidation, 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)

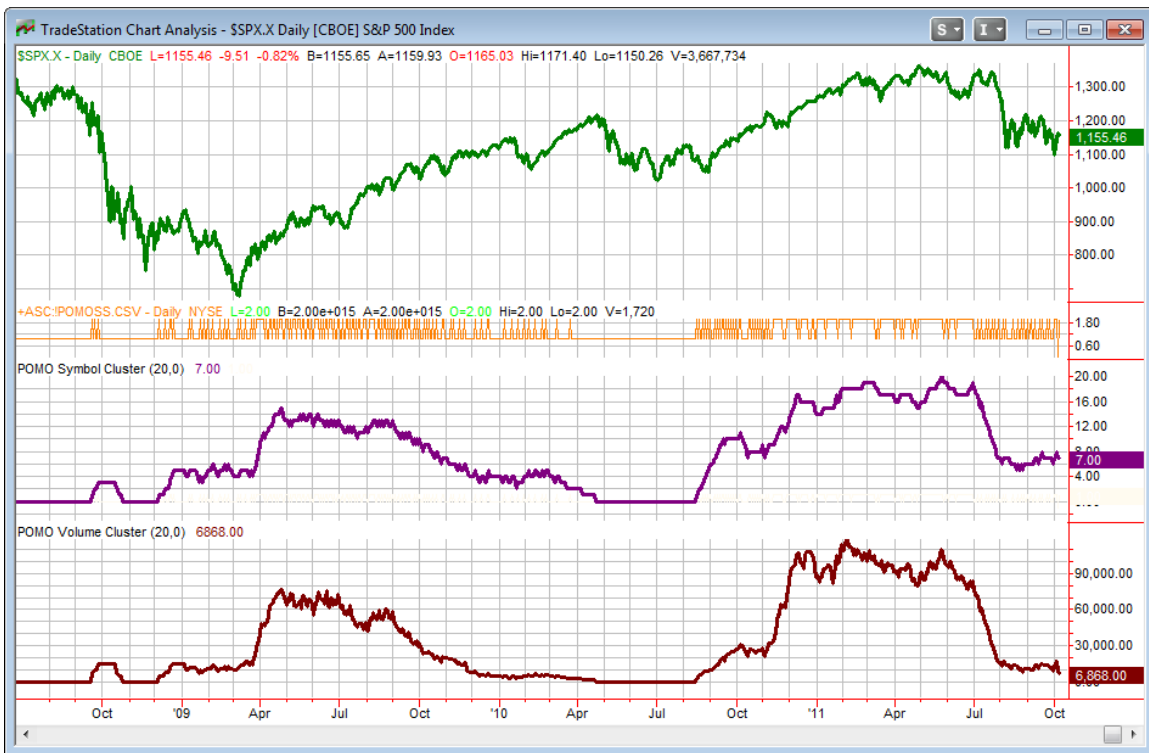
The August instance was a loser, but there still appears to be a healthy upside edge.

I'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>



Operation Twist kicked in this week. The Fed began buying more long-dated securities and selling some short-term ones. This came in the form of small amounts of buying on Mon, Tues, Wed, and Fri and a large amount of selling on Thursday. The result of the transactions was a small amount of net buying. Two weeks ago I discussed how the effect of Operation Twist may end up helping some sectors and hurting others. It is a bit soon to see how it will all play out, but below is an early scorecard showing how the sectors have perform both since operations began this past week and since the announcement 13 trading days ago.

Sector ETF Returns			
Symbol	Description	%Change this week	%Chg since announcement
IYR	iShares DJ US R/E Index Tr	(2.00)	(10.56)
IYZ	iShares DJ US Telecom Sect Ind	(1.62)	(7.43)
XLU	S&P Sel Utilities Spdr Fund	(0.65)	(2.57)
XLF	S&P Sel Financial Spdr Fund	0.17	(5.51)
XLV	S&P Sel Health Care Spdr Fund	0.54	(3.36)
XLP	S&P Sel Consum Staples Spdr Fu	1.38	(1.86)
XLK	S&P Sel Technology Spdr Fund	2.97	(2.25)
XLI	S&P Sel Industrial Spdr Fund	3.83	(3.50)
IYT	iShares DJ Transp Avg Ind Fd	3.87	(4.32)
XLE	S&P Sel Energy Spdr Fund	4.08	(7.19)
XLY	S&P Sel Consum Discretion'y Sp	4.27	(3.07)
XLB	S&P Sel Materials Spdr Fund	6.03	(7.41)

Real estate and telecom appear to be the losers so far. At this point there does not appear to be a clear leader. It will be interesting to see how this plays out over the next several weeks and months.

The market is trying to mount a rally. So far there has not been much indication that a new rally is likely to be successful. I suspect we will see more directional clues over the next few days. At this point I am not seeing any reason to start betting heavily on the long side. The market is only a few short days off its lows. I'll give this rally attempt some time to prove itself before taking a bullish stance.

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.

SPY – short ¼ index position @ \$120.00 LIMIT. Based on short-term outlook above. I will look to take a 2nd lot short on a retest of Tuesday's high.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	10/11/2011	\$119.58	\$119.70	-0.10%		Shorted at limit

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