

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 17, 2011

Volume 4 Issue 200

Market Overview



Signals Overview

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

Tonight's Research Points

- Extremely low volume at intermediate-term highs suggests a short-term pullback.
- The low volume on a day where SPX gains > 1% is also short-term bearish.
- SPX and the Dow 30 have both moved from a 50-day low to a 50-day high within 2 weeks. Past occurrences have led to bullish returns over the short and intermediate-term.
- The breakout to a new 50-day high was accompanied by 1) lower volume and 2) an unfilled gap up in the SPY. Both are short-term positives.
- The VXO is still extremely stretched, suggesting a quick pullback is likely.

Short-term Outlook

The Bottom Line

Evidence has gone from all short-term bearish the last couple of days to now being mixed. The breakout to new highs appears bullish. Still, the market is overdone, volume is not confirming, and the VXO remains incredibly stretched. I believe we are due for a quick (and perhaps sharp) drop in the next few days which may be followed by a further rally. I am currently 50% short and will be looking to cover that position if the market does dive as anticipated in the next day or so.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
October 17, 2011	SPX 20 high / up 1% on 20-low volume	1-2 days	Bearish	
October 17, 2011	VXO > 20% below 10ma	1-2 days	Bearish	
October 17, 2011	50-day high breakout. Unfilled gap low	1-5 days	Bullish	1.70%
October 13, 2011	3 up days. No 50-day low. < 200ma.	1-3 days	Bearish	-2.90%
October 12, 2011	5 higher highs no 20-day high	1-4 days	Bearish	-2.25%
Active - Long Term				
October 17, 2011	50-day low to 50-day high in 10 days	1-20 days	Bullish	
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	
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

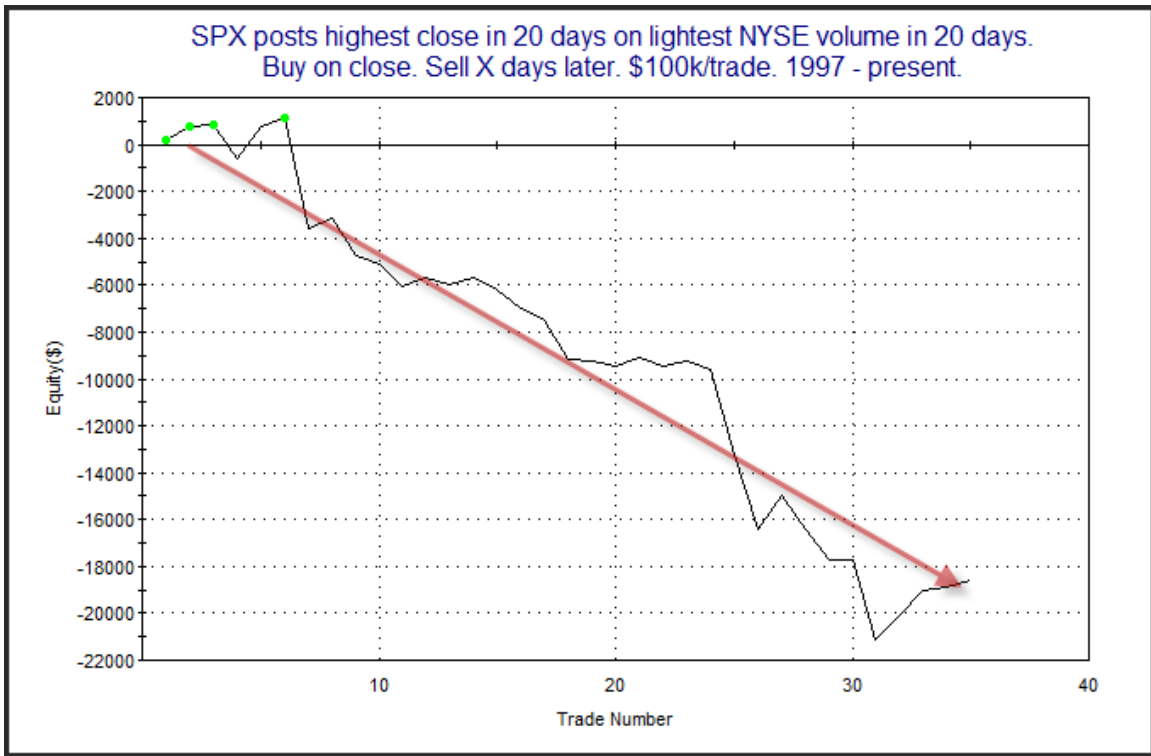
Another strong day of price action for the market. The SPX gained 1.7%, the Nasdaq rallied 1.8% and the Russell 2000 rose 2.0%. Breadth was also very strong as the NYSE Up Issues % came in at 83% and the Up Volume % was 88%. On the other hand, total NYSE volume was extremely light, registering the lowest day in over a month.

This market is getting really interesting, and there was quite a bit to look at this weekend. We are seeing extremely low volume, a historically sharp and persistent move lower in the VXO, and now a breakout to new intermediate-term highs. As you'll see that is a mix of good and bad.

Let's first consider the volume. One aspect of Friday's rally that was notable was that it occurred on the lightest volume in over a month. In the 2/15/11 Subscriber Letter I showed that when the SPX has made 20-day highs while the NYSE Volume comes in at the lowest level in 20 days, that will often be followed by a market pullback. I have updated that study tonight.

SPX posts highest close in 20 days on lightest NYSE volume in 20 days. Buy on close. Sell X days later. \$100k/trade. 1997 - 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	-19,416.04	32	12	20	37.50	1,250.04	-1,720.83	0.73	0.44	-606.75
4	-17,514.71	33	12	21	36.36	1,001.71	-1,406.44	0.71	0.41	-530.75
3	-16,848.81	33	13	20	39.39	793.43	-1,358.17	0.58	0.38	-510.57
2	-18,565.18	35	15	20	42.86	546.52	-1,338.15	0.41	0.31	-530.43
1	-9,305.26	37	15	22	40.54	312.75	-636.21	0.49	0.34	-251.49

The stats here are squarely bearish. You may find the profit curve for the 2-day exit strategy below.



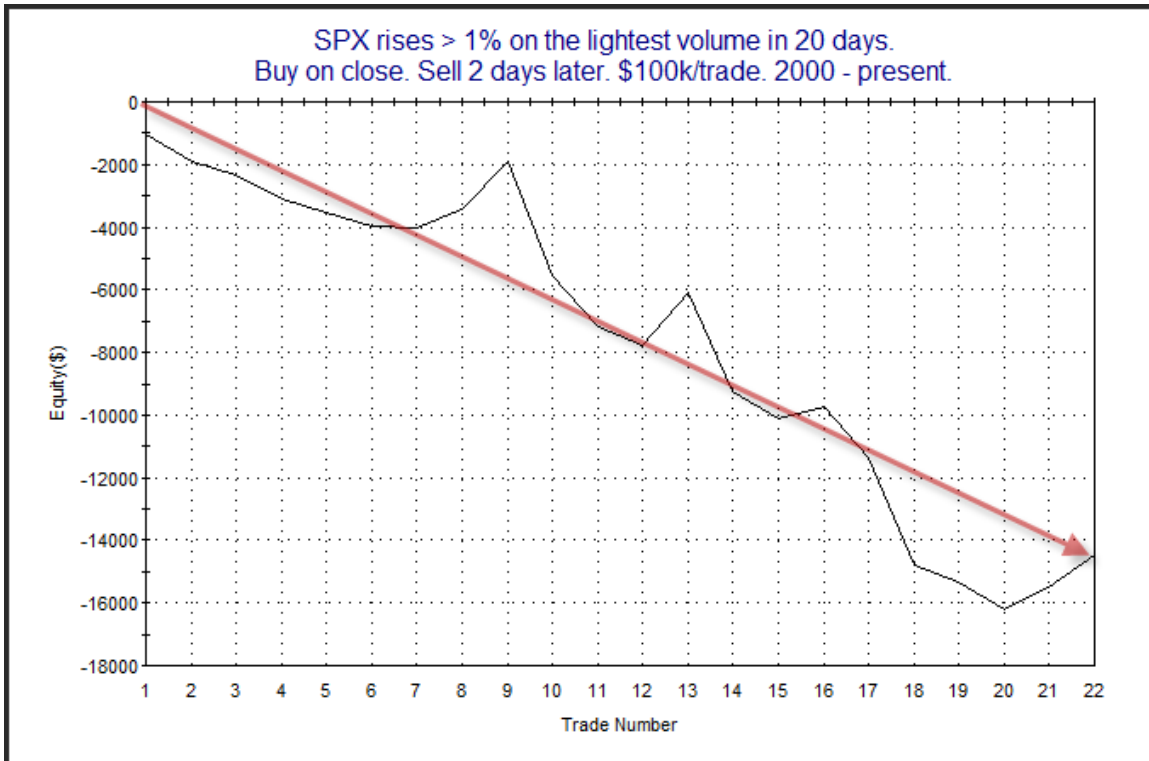
The last few instances have seen the curve move higher, but then downslope still seems to be intact.

This next study is from the 5/13/08 blog. It also looks at 20-day volume lows. This study looks at them in conjunction with 1% daily gains. Results are updated.

**SPX rises > 1% on the lightest volume in 20 days.
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	-23,447.52	21	9	12	42.86	1,713.16	-3,238.83	0.53	0.40	-1,116.55
4	-17,313.19	21	9	12	42.86	1,225.87	-2,362.17	0.52	0.39	-824.44
3	-19,071.29	22	9	12	40.91	1,195.07	-2,485.57	0.48	0.36	-866.88
2	-14,466.42	22	6	16	27.27	986.11	-1,273.94	0.77	0.29	-657.56
1	-7,700.67	22	8	14	36.36	636.20	-913.59	0.70	0.40	-350.03

Here again we see an apparent short-term downside edge. I also ran an equity curve on this one.



Like the 1st test we see the last couple of instances have not complied but at this point there still appears to be a downside edge.

One of the most remarkable things about this recent rally is that the market has moved from a 50-day closing low to a 50-day closing high in under 2 weeks. This is a rare occurrence. Below is a study that shows how the SPX has performed following other such instances.

SPX rallies from a 50-day closing low to a 50-day closing high within 10 days. Buy on close. Sell X days later. \$100k/trade. 1950 - 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	15,724.31	5	5	0	100.00	3,144.86	0.00	100.00	100.00	3,144.86
19	18,950.83	5	5	0	100.00	3,790.17	0.00	100.00	100.00	3,790.17
18	20,978.06	5	5	0	100.00	4,195.61	0.00	100.00	100.00	4,195.61
17	22,115.10	5	5	0	100.00	4,423.02	0.00	100.00	100.00	4,423.02
16	22,770.53	5	5	0	100.00	4,554.11	0.00	100.00	100.00	4,554.11
15	21,321.05	5	5	0	100.00	4,264.21	0.00	100.00	100.00	4,264.21
14	18,372.77	5	5	0	100.00	3,674.55	0.00	100.00	100.00	3,674.55
13	19,641.86	5	5	0	100.00	3,928.37	0.00	100.00	100.00	3,928.37
12	16,371.69	5	4	1	80.00	4,109.81	-67.55	60.84	243.36	3,274.34
11	15,038.26	5	5	0	100.00	3,007.65	0.00	100.00	100.00	3,007.65
10	14,690.34	5	4	1	80.00	3,677.41	-19.30	190.54	762.16	2,938.07
9	13,561.99	5	5	0	100.00	2,712.40	0.00	100.00	100.00	2,712.40
8	11,860.85	5	5	0	100.00	2,372.17	0.00	100.00	100.00	2,372.17
7	13,260.94	5	4	1	80.00	3,358.66	-173.70	19.34	77.34	2,652.19
6	10,639.71	5	5	0	100.00	2,127.94	0.00	100.00	100.00	2,127.94
5	10,601.30	5	5	0	100.00	2,120.26	0.00	100.00	100.00	2,120.26
4	7,448.00	5	4	1	80.00	1,948.85	-347.40	5.61	22.44	1,489.60
3	7,831.82	5	4	1	80.00	1,991.73	-135.10	14.74	58.97	1,566.36
2	5,508.91	5	4	1	80.00	1,406.91	-118.72	11.85	47.40	1,101.78
1	4,676.03	5	3	2	60.00	1,877.28	-477.90	3.93	5.89	935.21

There have only been 5 occurrences but the stats are overwhelmingly bullish over the next month. The profit maxes out on day 16 in the table above. To getting a better feel for the instances I have listed them all below along with their 16-day stats.

SPX rallies from a 50-day closing low to a 50-day closing high within 10 days. Buy on close. Sell 16 days later. \$100k/trade. 1950 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
08/01/61	Buy	\$67.37	0.91%	\$1,587.88
08/23/61	Sell	\$67.98		(\$638.12)
06/17/76	Buy	\$103.61	2.21%	\$2,209.85
07/12/76	Sell	\$105.90		(\$347.40)
08/20/82	Buy	\$113.02	8.92%	\$10,440.04
09/14/82	Sell	\$123.10		(\$928.20)
08/02/84	Buy	\$157.99	6.02%	\$6,831.92
08/24/84	Sell	\$167.50		\$0.00
06/24/98	Buy	\$1,132.89	4.75%	\$4,858.48
07/17/98	Sell	\$1,186.69		(\$465.52)
Avg Run-up: \$5,186 Avg Drawdown: -\$476				

Five instances is too small to draw any solid conclusions or generate estimates from. These stats are incredibly lopsided, though so it may be worth consideration. The average run-up of the 5 instances is over 10x the size of the average drawdown.

This setup also triggered in the Dow on Friday. And since there were only 5 SPX instances dating back to the 50s I decided to also run the study on the Dow. In this case I was able to use data going back to 1919.

Dow 30 rallies from a 50-day closing low to a 50-day closing high within 10 days. Buy on close. Sell X days later. \$100k/trade. 1919 - 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	30,509.97	15	12	3	80.00	3,341.69	-3,196.77	1.05	4.18	2,034.00
19	32,715.81	15	11	4	73.33	3,888.02	-2,513.10	1.55	4.25	2,181.05
18	33,076.67	15	11	4	73.33	3,827.45	-2,256.31	1.70	4.66	2,205.11
17	34,867.41	15	11	4	73.33	3,830.28	-1,816.43	2.11	5.80	2,324.49
16	32,635.89	15	11	4	73.33	3,664.50	-1,918.41	1.91	5.25	2,175.73
15	29,614.14	15	10	5	66.67	3,850.61	-1,778.40	2.17	4.33	1,974.28
14	35,335.94	15	11	4	73.33	3,618.26	-1,116.24	3.24	8.91	2,355.73
13	33,121.42	15	10	5	66.67	3,767.60	-910.92	4.14	8.27	2,208.09
12	28,931.19	15	10	5	66.67	3,398.27	-1,010.31	3.36	6.73	1,928.75
11	29,603.64	15	11	4	73.33	3,078.16	-1,064.02	2.89	7.96	1,973.58
10	26,280.68	15	12	2	80.00	2,396.04	-1,235.88	1.94	11.63	1,752.05
9	24,797.38	15	12	3	80.00	2,353.99	-1,150.17	2.05	8.19	1,653.16
8	25,449.29	15	11	4	73.33	2,715.08	-1,104.15	2.46	6.76	1,696.62
7	24,065.62	15	10	5	66.67	2,838.54	-863.95	3.29	6.57	1,604.37
6	26,765.31	15	11	4	73.33	2,722.88	-796.60	3.42	9.40	1,784.35
5	28,035.98	15	13	2	86.67	2,272.81	-755.28	3.01	19.56	1,869.07
4	23,085.66	15	14	1	93.33	1,711.19	-871.00	1.96	27.50	1,539.04
3	20,792.02	15	13	2	86.67	1,646.81	-308.27	5.34	34.72	1,386.13
2	15,465.15	15	11	4	73.33	1,539.10	-366.23	4.20	11.56	1,031.01
1	6,298.43	15	8	7	53.33	1,129.99	-391.64	2.89	3.30	419.90

While not quite as pronounced as the SPX stats these certainly appear to be strongly bullish. Below I have listed all the instances along with their 20-day returns.

Dow 30 rallies from a 50-day closing low to a 50-day closing high within 10 days.
Buy on close. Sell 20 days later. \$100k/trade. 1919 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
09/09/21	Buy	\$70.60	0.14%	\$1,557.60
10/07/21	Sell	\$70.70		(\$3,964.80)
10/05/38	Buy	\$148.30	2.70%	\$4,785.40
11/03/38	Sell	\$152.30		(\$674.00)
03/31/48	Buy	\$177.20	2.14%	\$4,117.20
04/28/48	Sell	\$181.00		(\$676.80)
08/01/61	Buy	\$713.90	0.04%	\$2,268.00
08/29/61	Sell	\$714.20		(\$840.00)
11/07/62	Buy	\$615.80	5.83%	\$6,949.80
12/06/62	Sell	\$651.70		(\$1,701.00)
12/05/63	Buy	\$763.90	0.73%	\$1,287.00
01/06/64	Sell	\$769.50		(\$1,443.00)
04/03/68	Buy	\$869.10	5.76%	\$7,659.00
05/03/68	Sell	\$919.20		(\$805.00)
10/16/69	Buy	\$838.80	1.32%	\$3,927.00
11/13/69	Sell	\$849.90		(\$1,094.80)
11/13/80	Buy	\$982.40	(6.64%)	\$2,727.00
12/12/80	Sell	\$917.20		(\$8,776.90)
08/19/82	Buy	\$838.60	9.34%	\$12,126.10
09/17/82	Sell	\$916.90		\$0.00
08/01/84	Buy	\$1,134.60	8.14%	\$10,489.60
08/29/84	Sell	\$1,226.90		\$0.00
08/23/91	Buy	\$3,040.25	(0.98%)	\$687.04
09/23/91	Sell	\$3,010.51		(\$2,168.00)
04/14/92	Buy	\$3,306.13	2.60%	\$2,836.20
05/13/92	Sell	\$3,391.98		(\$657.60)
05/20/96	Buy	\$5,748.82	(2.10%)	\$803.76
06/18/96	Sell	\$5,628.03		(\$2,863.48)
11/05/04	Buy	\$10,387.54	1.54%	\$2,299.59
12/06/04	Sell	\$10,547.06		(\$234.90)

There certainly seems to be an upside inclination that goes with this setup.

The strong breadth we have seen over the last couple of weeks has caused the 10-day exponential moving average of the Up Issues % to rise to nearly 61.5%. A move through 61.5% after being below 40% within the last 2 weeks would trigger a Zweig Breadth Thrust. This is a signal created by Martin Zweig. Over the long haul it has been a rare but powerful signal. It appeared near the close that the 61.5% threshold would be broken. It appears after the close that it just missed according to Tradestation's data. In any case, it could trigger on Monday even if it failed Friday. And it came so close that I thought it would be worth taking a look at past signals. I have listed all of the signals since 1970 below.

Zweig Breadth Thrusts for SPX.
20-day holding period results. \$100k/trade. 1970 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
12/03/71	Buy	\$97.06	4.75%	\$5,304.50
01/03/72	Sell	\$101.67		(\$566.50)
10/10/74	Buy	\$69.79	7.77%	\$7,761.44
11/07/74	Sell	\$75.21		\$0.00
01/03/75	Buy	\$70.71	8.87%	\$9,261.70
01/31/75	Sell	\$76.98		(\$947.38)
08/20/82	Buy	\$113.02	8.39%	\$11,103.04
09/20/82	Sell	\$122.50		(\$928.20)
08/03/84	Buy	\$162.35	2.66%	\$3,966.75
08/31/84	Sell	\$166.67		(\$953.25)
03/18/09	Buy	\$794.35	8.93%	\$9,500.00
04/16/09	Sell	\$865.30		(\$3,518.75)

Here again we see very strong moves higher over the next month with very limited downside.

In addition to the sharp move from the low, and the possible Zweig Breadth signal, there were some other appealing aspects of the 50-day high breakout on Friday. Before I get into them I should note that I consider it a breakout because it has been over 10 days since the SPX last made a 50-day high. In the past I have found a basing period of at least this length to be reasonable and significant. And while I discussed earlier that the extremely low volume was likely not a good thing, the fact that it was lower than yesterday when breaking out to a 50-day high has typically been bullish. I last showed this in the 12/9/10 subscriber letter. The studies below are all updated.

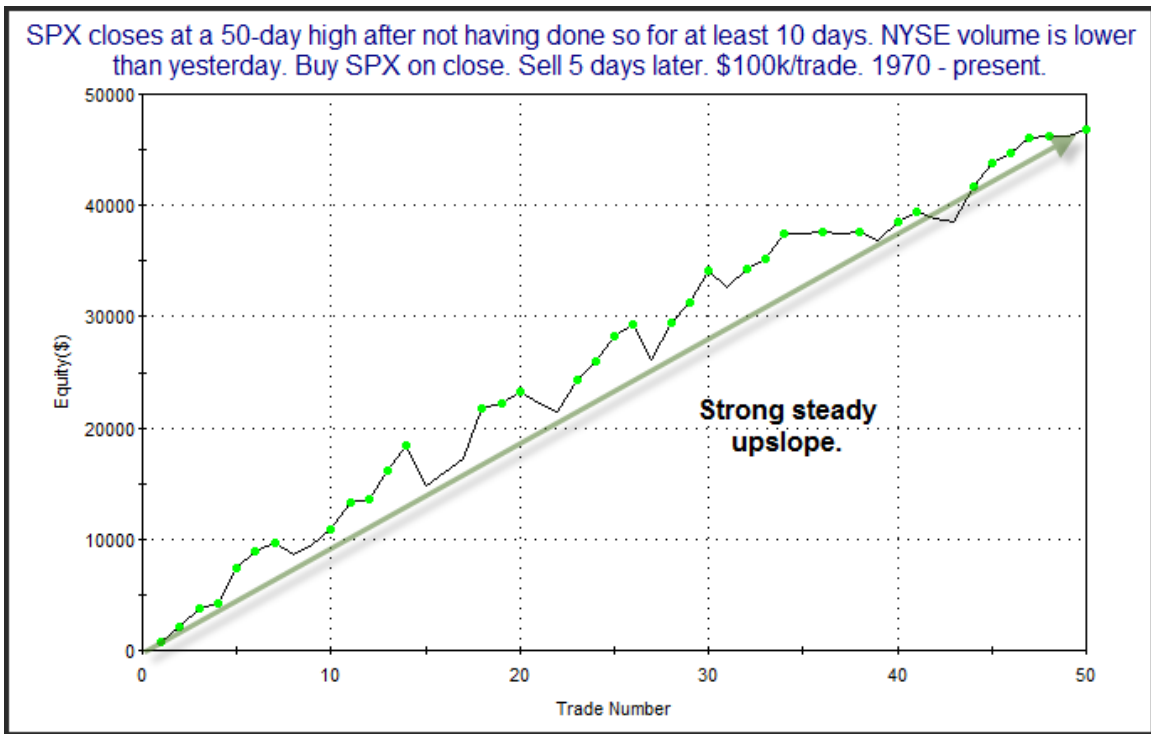
SPX closes at a 50-day high after not having done so for at least 10 days. NYSE volume is lower than yesterday. Buy SPX on close. Sell X days later. \$100k/trade. 1970 - present.

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
20	21,753.37	47	27	20	57.45	2,637.68	-2,473.20	1.07	1.44	462.84
19	27,859.40	48	28	20	58.33	2,622.91	-2,279.10	1.15	1.61	580.40
18	29,314.99	48	29	19	60.42	2,632.58	-2,475.25	1.06	1.62	610.73
17	27,383.11	48	29	19	60.42	2,602.01	-2,530.27	1.03	1.57	570.48
16	29,450.53	48	30	18	62.50	2,487.63	-2,509.92	0.99	1.65	613.55
15	24,941.99	48	31	17	64.58	2,338.44	-2,797.04	0.84	1.52	519.62
14	29,481.79	49	34	15	69.39	2,041.48	-2,661.90	0.77	1.74	601.67
13	31,075.04	50	32	18	64.00	2,102.79	-2,011.91	1.05	1.86	621.50
12	19,575.25	50	28	22	56.00	2,135.77	-1,828.47	1.17	1.49	391.50
11	13,478.52	50	26	24	52.00	2,101.85	-1,715.40	1.23	1.33	269.57
10	15,314.03	50	25	25	50.00	2,055.87	-1,443.30	1.42	1.42	306.28
9	24,557.78	50	33	17	66.00	1,586.87	-1,635.83	0.97	1.88	491.16
8	34,416.44	50	35	15	70.00	1,571.25	-1,371.82	1.15	2.67	688.33
7	33,445.02	50	34	16	68.00	1,453.68	-998.76	1.46	3.09	668.90
6	42,688.54	50	36	14	72.00	1,495.78	-797.10	1.88	4.83	853.77
5	46,802.48	50	38	12	76.00	1,574.86	-1,086.84	1.45	4.59	936.05
4	34,899.27	50	37	13	74.00	1,292.17	-993.16	1.30	3.70	697.99
3	33,229.29	50	34	16	68.00	1,281.54	-646.44	1.98	4.21	664.59
2	19,250.11	50	34	16	68.00	888.61	-685.17	1.30	2.76	385.00
1	9,245.66	50	32	17	64.00	496.62	-390.96	1.27	2.39	184.91

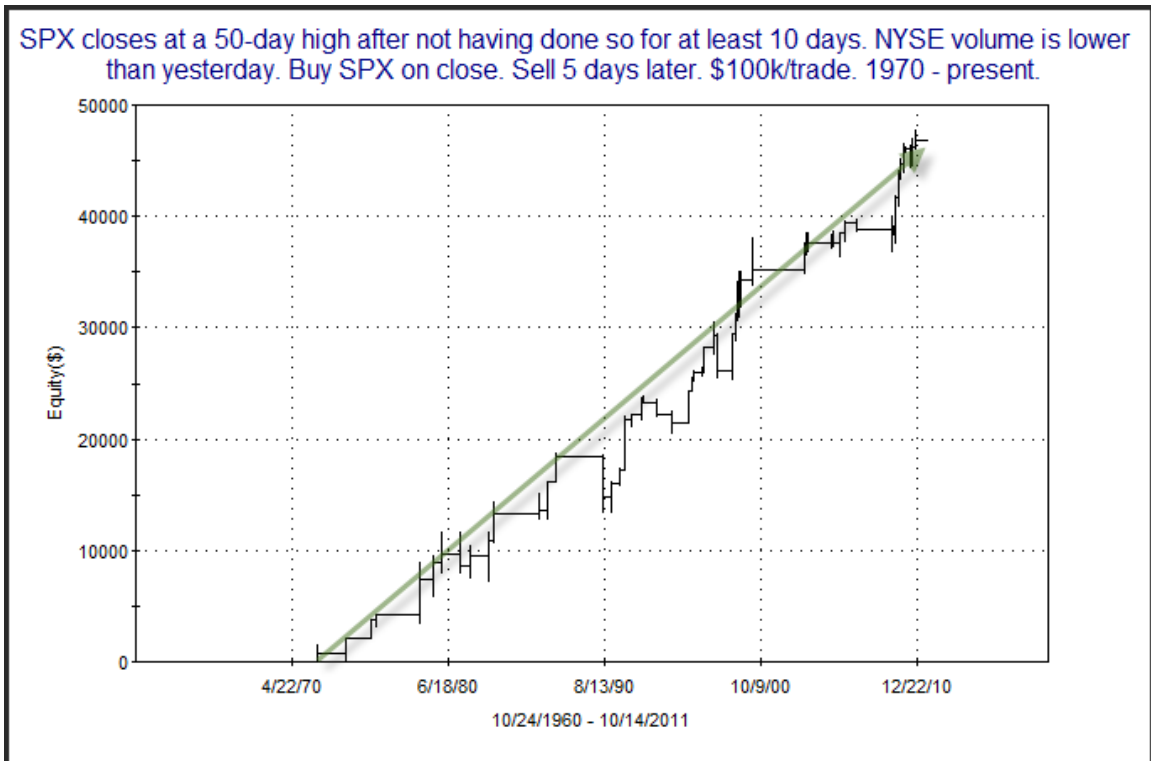
47 of 50 instances (94%) posted a close above the entry price at some point in the next 5 days.

Here we see that there appears to be a strong upside inclination over the first week. Beyond that there isn't much of an edge.

To see how the 1-week edge has played out over time I have produced a profit curve below.



Profit curves don't often get steadier and smoother than this one. I also ran it using time instead of instances in the x-axis.



This provides further illustration of the persistent upside edge.

For comparison, as I also did in that 12/9/10 letter, I ran the breakout stats when the breakout came on increased volume rather than lower volume. Those are updated below.

SPX closes at a 50-day high after not having done so for at least 10 days. NYSE volume is higher than yesterday. 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
20	5,783.22	117	56	61	47.86	3,666.53	-3,271.19	1.12	1.03	49.43
19	22,288.08	119	62	57	52.10	3,404.15	-3,311.74	1.03	1.12	187.29
18	33,243.41	119	62	57	52.10	3,390.47	-3,104.66	1.09	1.19	279.36
17	24,701.27	119	64	55	53.78	3,129.73	-3,192.76	0.98	1.14	207.57
16	27,247.67	121	65	56	53.72	3,048.43	-3,051.79	1.00	1.16	225.19
15	30,630.56	122	63	59	51.64	3,052.05	-2,739.81	1.11	1.19	251.07
14	20,616.55	122	66	56	54.10	2,796.45	-2,927.66	0.96	1.13	168.99
13	24,068.94	122	64	58	52.46	2,770.32	-2,641.92	1.05	1.16	197.29
12	13,535.05	122	65	57	53.28	2,483.29	-2,594.37	0.96	1.09	110.94
11	16,471.77	125	65	60	52.00	2,538.07	-2,475.05	1.03	1.11	131.77
10	12,359.39	125	62	63	49.60	2,411.45	-2,176.99	1.11	1.09	98.88
9	14,724.36	125	60	64	48.00	2,344.16	-1,967.59	1.19	1.12	117.79
8	11,454.11	125	65	60	52.00	1,979.89	-1,953.98	1.01	1.10	91.63
7	27,931.09	125	64	61	51.20	1,954.98	-1,593.24	1.23	1.29	223.45
6	28,753.67	125	71	54	56.80	1,631.18	-1,612.23	1.01	1.33	230.03
5	24,412.79	125	64	61	51.20	1,663.87	-1,345.49	1.24	1.30	195.30
4	12,299.64	125	68	57	54.40	1,320.02	-1,358.97	0.97	1.16	98.40
3	22,073.52	125	73	52	58.40	1,169.20	-1,216.89	0.96	1.35	176.59
2	25,890.23	125	76	48	60.80	919.17	-915.97	1.00	1.59	207.12
1	22,379.61	125	77	48	61.60	584.98	-472.16	1.24	1.99	179.04

As you can see, higher volume breaks to new highs do not carry the same bullish implications. These stats appear to be almost dead neutral.

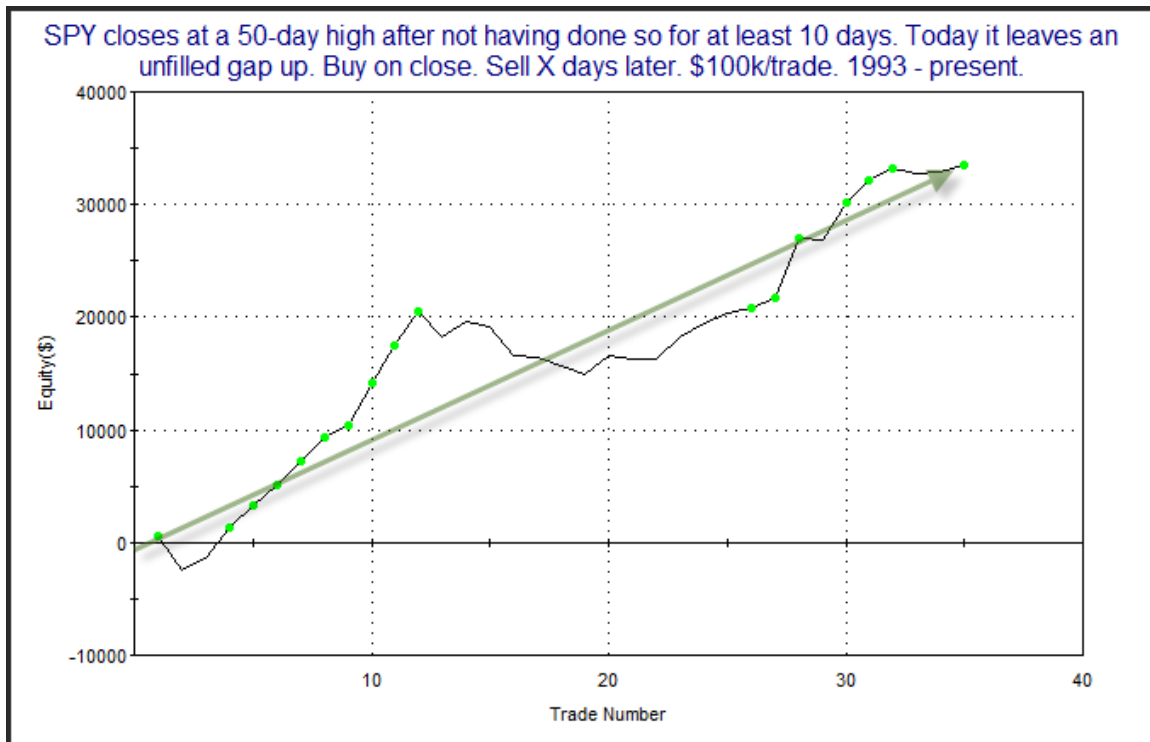
Another aspect of the breakout on Friday that would seem to favor the bulls over the short-term is that it came with an unfilled upside gap. In the 4/27/11 subscriber letter I looked at the importance of an unfilled upside gap. I have revisited that study below.

SPY closes at a 50-day high after not having done so for at least 10 days. Today it leaves an unfilled gap up. 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	33,574.93	35	25	10	71.43	1,791.47	-1,121.18	1.60	3.99	959.28
4	24,771.73	35	26	9	74.29	1,402.41	-1,299.00	1.08	3.12	707.76
3	21,526.76	35	26	9	74.29	1,251.61	-1,223.89	1.02	2.95	615.05
2	13,893.71	35	24	11	68.57	931.07	-768.37	1.21	2.64	396.96
1	5,635.15	35	25	10	71.43	553.94	-821.33	0.67	1.69	161.00

31 of 35 instances (89%) posted a close above the entry price at some point in the next 4 days.

Results here are strong across the board. Below is an equity curve using a 5-day holding period.



The nice upslope on the equity curve confirms the bullish inclinations.

Technicians will often use the term “breakaway gap”. This suggests the gap occurs on the same day as a base breakout. The idea is that the new high causes excitement and the gap leaves a good amount of people sidelined or stuck short. When it doesn’t immediately fill, it leads these people to chase and helps to propel the market even higher.

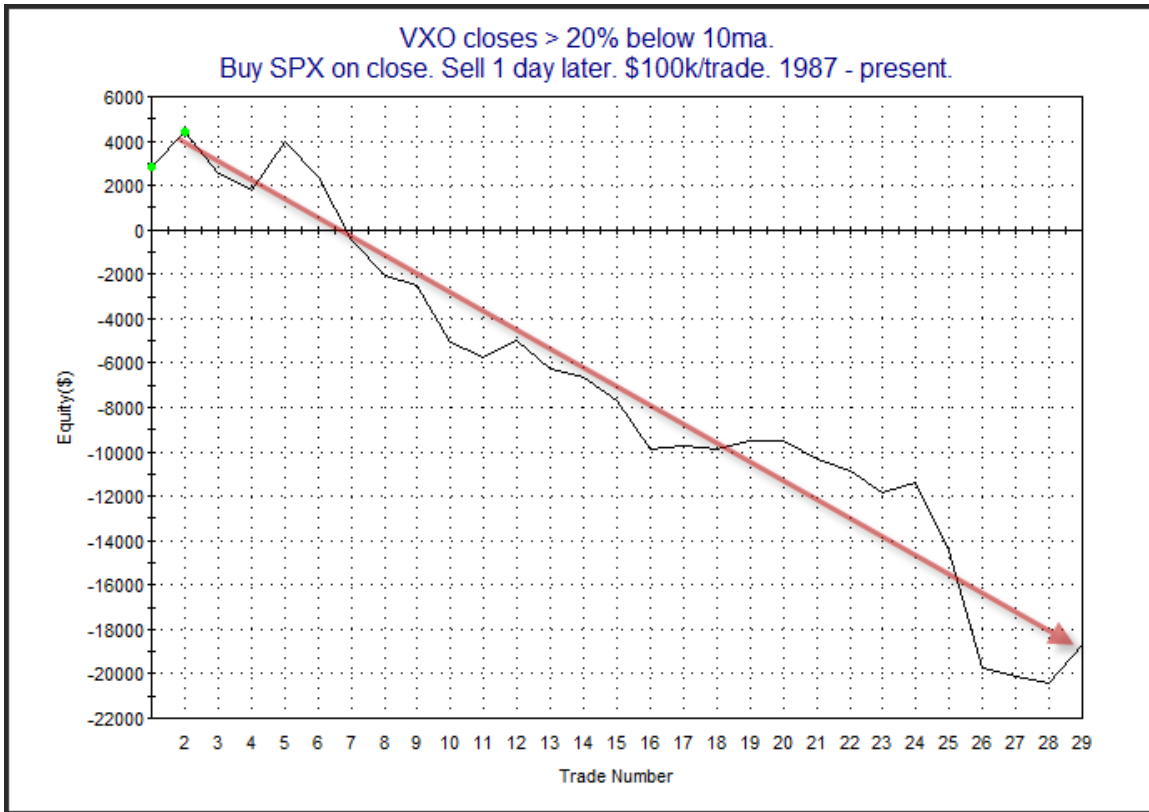
Now let’s look at instances where the 50-day high breakout was not accompanied by an unfilled gap. Interestingly, the number of instances was nearly the same. This study also appeared in the 4/27/11 Letter and is updated.

SPY closes at a 50-day high after not having done so for at least 10 days. No unfilled gap today.
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	2,482.20	37	22	15	59.46	1,035.77	-1,353.65	0.77	1.12	67.09
4	-1,198.15	37	19	18	51.35	1,081.98	-1,208.65	0.90	0.94	-32.38
3	3,273.35	37	20	17	54.05	1,091.84	-1,091.97	1.00	1.18	88.47
2	-1,546.37	37	18	19	48.65	700.55	-745.07	0.94	0.89	-41.79
1	395.34	37	19	17	51.35	486.74	-520.75	0.93	1.04	10.68

As you can see these moves to new highs that don't start with an unfilled gap are much less reliable.

So the strength of this rally has certainly been impressive and it appears to be suggesting the market is likely to move higher over the next week or longer. But one indicator that has been a major concern over the last couple of days remains a major concern. The VXO closed more than 20% below its 10ma for the 3rd day in a row on Friday. This is a fairly remarkable feat. It was only ever accomplished one other time. That was when it did it 6 days in a row in November and December of 1987. I've looked at the stretched VXO a few different ways over the last couple of days. I decided to run a simple equity curve to see if the edge seemed to be waning. The curve below simply considers the 1-day returns of SPX following any day when the VXO is stretched 20% below its 10ma.



Really what we are looking at here is one bad day (Friday) that seems to have put nothing more than a blip on this chart. For those more accustomed to numbers – here they are.

VXO closes > 20% below 10ma.
Buy SPX on close. Sell 1 day later. \$100k/trade. 1987 - present.

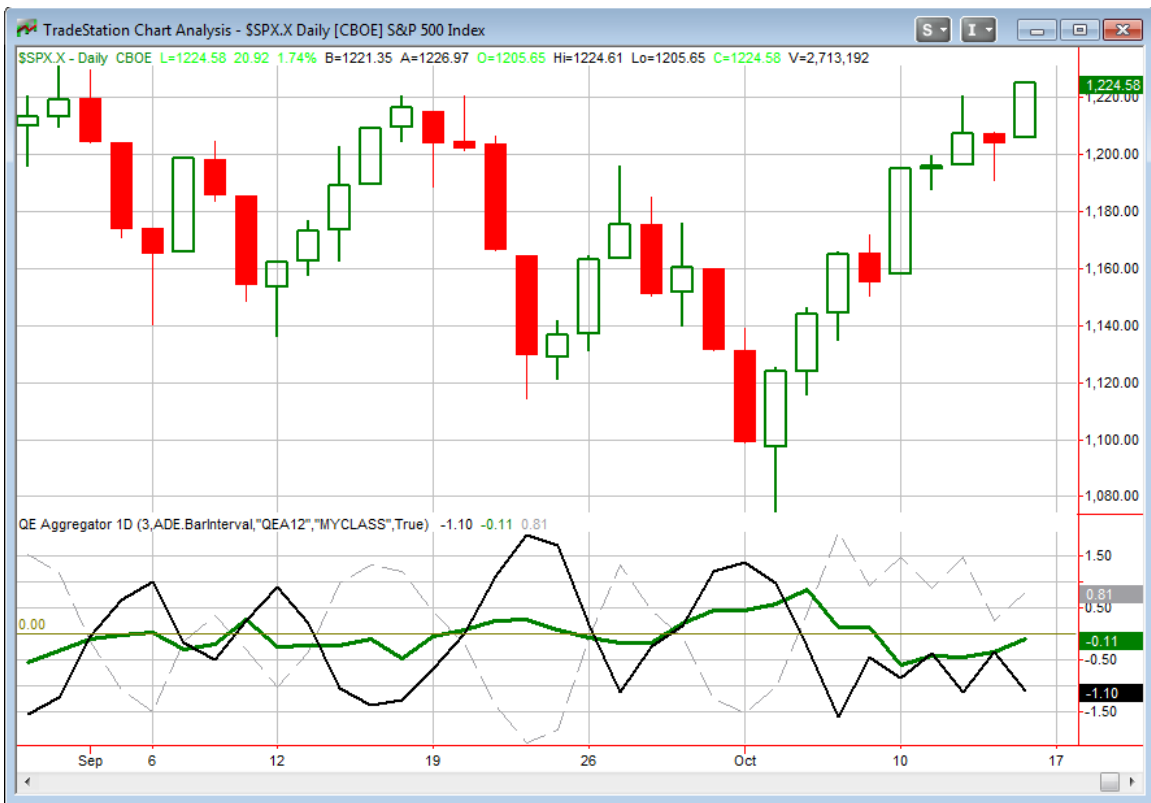
TradeStation Performance Summary			
All Trades			
Total Net Profit	(\$18,662.78)	Profit Factor	0.35
Gross Profit	\$10,048.08	Gross Loss	(\$28,710.86)
Total Number of Trades	29	Percent Profitable	27.59%
Winning Trades	8	Losing Trades	21
Even Trades	0		
Avg. Trade Net Profit	(\$643.54)	Ratio Avg. Win:Avg. Loss	0.92
Avg. Winning Trade	\$1,256.01	Avg. Losing Trade	(\$1,367.18)
Largest Winning Trade	\$2,860.08	Largest Losing Trade	(\$5,245.02)

Everything here seems to strongly favor the bears. And if you look out more than just 1 day you'll see the following stats.

VXO closes > 20% below 10ma. Buy SPX on close. Sell X days later. \$100k/trade. 1987 - 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	-50,739.17	20	6	14	30.00	1,222.66	-4,148.22	0.29	0.13	-2,536.96
4	-44,557.40	20	6	14	30.00	763.59	-3,509.92	0.22	0.09	-2,227.87
3	-32,950.24	21	6	15	28.57	901.55	-2,557.30	0.35	0.14	-1,569.06
2	-41,860.84	23	6	17	26.09	1,444.41	-2,972.19	0.49	0.17	-1,820.04
1	-18,662.78	29	8	21	27.59	1,256.01	-1,367.18	0.92	0.35	-643.54

As I mentioned there is quite a bit to consider. The extremely low volume and VXO appear to suggest a 1-2 day pullback while the new breakout suggests a rise in prices over the next week or more.

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



With all of the above to consider the green Aggregator line rose some but still remained negative. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the black Differential Line is again well 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 strongly 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 green Aggregator line really could flip either way on Monday. Additional bullish evidence or a rise in the VXO could cause it to turn positive. On the other hand, negative patterns, low volume, or a further drop in the VXO would likely cause the Aggregator to remain negative. Meanwhile, the Differential Pivot will be 1,189.14. This is about 2.9% below Friday's close. So it would take a huge drop of at least this much in order to flip the Differential line positive. It would likely take a much smaller drop to flip the green Aggregator line. So we could very well see the short signal persist if the SPX rises, the signal turn neutral on a drop in the SPX, or a long signal if the market completely falls apart and drops below the Differential Pivot.

I have had a 50% short position for the last couple of days. I am not going to do anything just yet, but will be ready to cover some or all on Monday and/or Tuesday should we get a pullback. At this point it still appears to me that the most likely course would be a dip over the next day or so followed by a move higher near the end of the week. If I was more confident in the dip then I would consider buying some VXX here. But with the fresh breakout and the fact that the VIX futures have moved back to contango VXX becomes more dangerous. It's a little early to tell but my focus may soon switch from shorting rallies to buying pullbacks. And if the contango strengthens then I may do a fair amount of the buying using XIV. But now I'm getting ahead of myself...

Intermediate-term Outlook (2 weeks – 2 months)– updated 10/17 – neutral

This past week certainly changed things in a hurry. As noted above we have moved from 50-day lows to 50-day highs and also above the consolidation of the last 2 months.

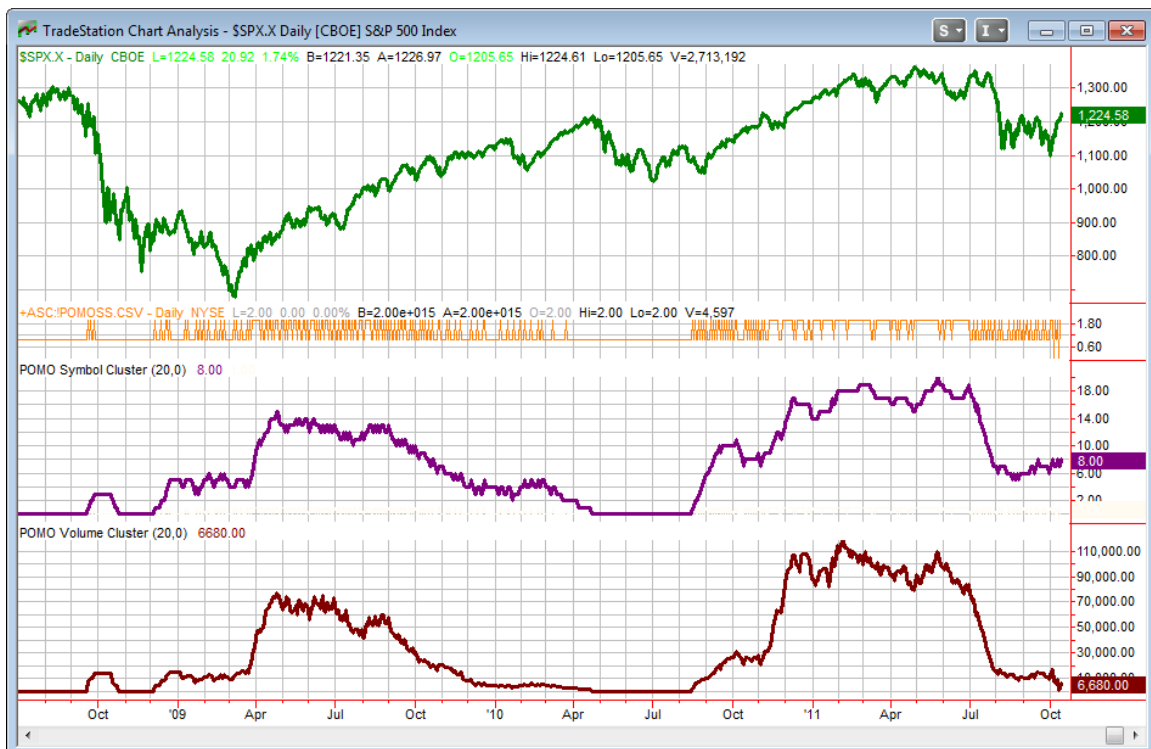
From an intermediate-term perspective, one of the more amazing things I've notice about this rally is that it has come without any 1% Follow Through Day (FTD) on rising volume. Investors' Business Daily first published and popularized the concept of the Follow Through Day (FTD). Though they have changed the definition slightly over the years, I have found their original definition to be useful in several studies. My tests go back to 1971, which was the inception of the Nasdaq, and also as far as some of my volume data goes. Since that time there has never been a rally that has taken the SPX from a drawdown of at least 8% to a new 50-day high that was not inclusive of a FTD – until Friday.

This puts this rally in uncharted territory, which is always a little bit of an uncomfortable place for me. A FTD could still occur, and just because we have had a strong 9-day rally does not mean a bull market has already been missed. But a primary purpose of the FTD concept is to help in identifying market bottoms. If we are already at a 50-day high, then I would say this is one case where the FTD concept has failed us.

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>



The market began its rally almost exactly when Operation Twist began. This could be coincidental, and seems odd since the net amount of the buying has been reduced versus previous buying. This is because we have seen increased buying on the long end largely offset by selling short-dated securities. Perhaps the focus on purchasing longer-dated securities has somehow helped. It is difficult to draw any solid conclusions yet. At this point I can say we are seeing a new rally occur in conjunction with new Fed action. I may not be smart enough to fully explain “why”, but I am smart enough to know I shouldn’t dismiss it, especially after observing the impact QE1 and QE2 had on the market.

I’m somewhat neutral at this point. I’ll trade in either direction with similar aggressiveness. As we’ve seen the last couple of weeks, things can change quickly. I suspect the quick move from a 50-day low to a 50-day high may turn out to be a bullish intermediate-term sign as it has in the past. Still, I’d prefer to see some volume behind the move, and I want to see the VIX and VXO exhibit more normal behavior. If some of these things can occur this upcoming week, then I may turn outright bullish.

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
SPY(1/4)(s)	10/11/2011	\$119.58	\$122.57	-2.50%		Aggregator
SPY(1/4)(s)	10/12/2011	\$120.60	\$122.57	-1.63%		Aggregator

I will cover both lots if the SPX closes \leq the Differential Pivot of 1,189.14.

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