

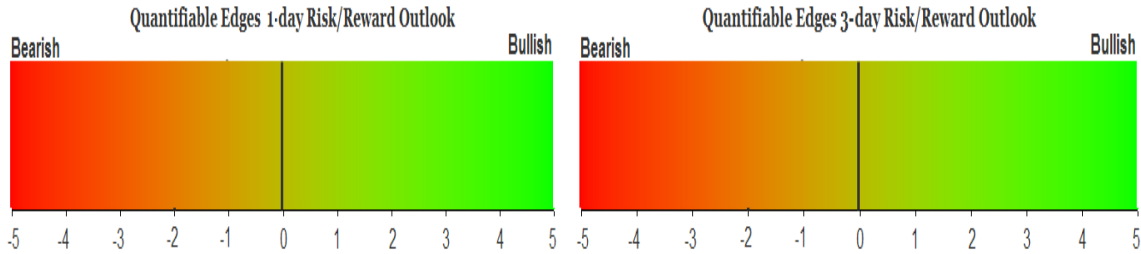
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 31, 2011

Volume 4 Issue 210

## Market Overview



## Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Flat	50% Long XIV	Flat	Flat

## Tonight's Research Points

- Friday's inside day following the unfilled gap to a 50-day high on Thursday suggests Monday is likely to close higher.
- Bond rates hitting 50-day highs along with the SPX on Thursday was a possible bearish sign.

## Short-term Outlook

### The Bottom Line

I was neutral Thursday afternoon and Friday's lack of action did nothing to change that.

## 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 31, 2011	Unfilled gap to 50-high then inside day	1 day	Bullish	
October 28, 2011	3% gain high volume 10days	1-3 days	Bullish	
October 28, 2011	Double 90% breadth & 50-day high	1-4 days	Bullish	
October 28, 2011	Gap -n- go	1-3 days	Bearish	
<b>Active - Long Term</b>				
October 30, 2011	Gap -n- go	1-3 days	Bearish	
October 19, 2011	50-day high on 90% up vol	1-50 days	Bullish	
October 19, 2011	FTD on strong breadth/20day high	int term	Bullish	
October 17, 2011	50-day low to 50-day high in 10 days	1-20 days	Bullish	
March 22, 2011	3 Days Up Issues % > 70%	8 months	Bullish	19.00%
<b>Dropped Tonight</b>				
October 25, 2011	SPY up > 1% 2x. 10-high < 200ma	1-4 days	Bearish	-3.50%
October 11, 2011	2nd 90% up vol in a week	1-14 days	Bullish	

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

## The Evidence

Nothing happened Friday. Well, the Russell 2000 moved a little. It was down 0.6%. But the SPX gained 0.04% and the Nasdaq was down 0.05%. Breadth was indecisive as the NYSE Up Issues % came in at 55% and the Up Volume % was 52%. Total NYSE volume took a dive after Thursday's spike.

With little movement there wasn't much of significance that triggered. During downtrends narrow range days and inside days like we saw on Friday will often be followed by a drop, especially if they occur after a few up days. ("Inside day" means the market posted a lower high and a higher low than the day before.) With the market in an intermediate-term rally and at a 50-day high implications are not bearish. A more common result is that the inside day acts as a consolidation before a continuation of the move higher. The study below looks at times like the past 2 days when you had a unfilled gap up to a 50-day high followed by an inside day. It was last seen in the 1/14/11 subscriber letter.

After posting an unfilled gap up and a 50-day closing high yesterday the SPY posts an inside day today. Buy on close. Sell next day's close. \$100k/trade. 1998 - present.

TradeStation Performance Summary <span style="float: right;">Collapse ^</span>			
All Trades			
Total Net Profit	\$8,177.17	Profit Factor	7.77
Gross Profit	\$9,384.59	Gross Loss	(\$1,207.42)
Total Number of Trades	13	Percent Profitable	76.92%
Winning Trades	10	Losing Trades	3
Even Trades	0		
Avg. Trade Net Profit	\$629.01	Ratio Avg. Win:Avg. Loss	2.33
Avg. Winning Trade	\$938.46	Avg. Losing Trade	(\$402.47)
Largest Winning Trade	\$2,094.84	Largest Losing Trade	(\$664.56)

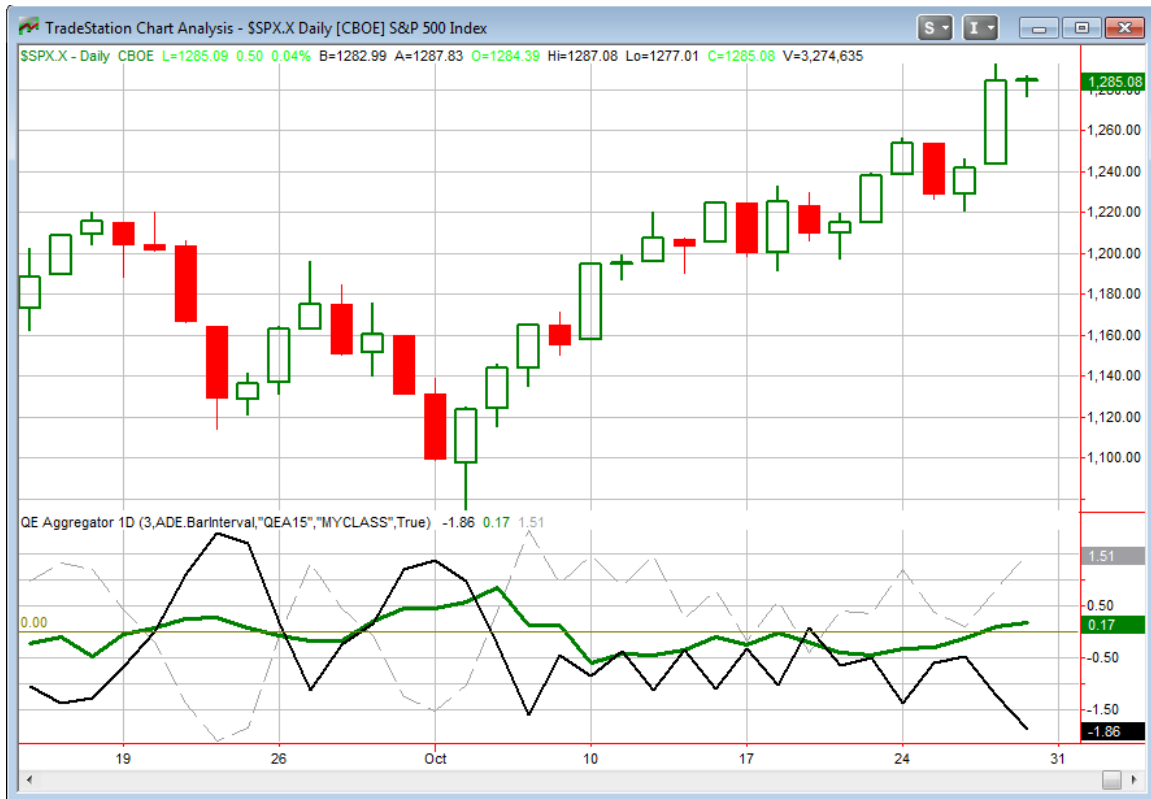
Though instances are a bit low, the stats all strongly favor a move higher the next day. Below is a list of all the instances.

After posting an unfilled gap up and a 50-day closing high yesterday the SPY posts an inside day today. Buy on close. Sell next day's close. \$100k/trade. 1998 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
07/02/98	Buy	\$114.72	1.01%	\$1,010.36
07/06/98	Sell	\$115.88		(\$139.36)
11/03/98	Buy	\$111.06	1.07%	\$1,827.00
11/04/98	Sell	\$112.25		\$0.00
12/22/98	Buy	\$120.69	2.10%	\$2,094.84
12/23/98	Sell	\$123.22		\$0.00
01/07/99	Buy	\$126.81	0.74%	\$1,331.72
01/08/99	Sell	\$127.75		(\$488.56)
11/17/99	Buy	\$141.63	0.71%	\$967.22
11/18/99	Sell	\$142.63		\$0.00
12/06/01	Buy	\$117.34	(0.66%)	\$0.00
12/07/01	Sell	\$116.56		(\$1,397.28)
05/08/06	Buy	\$132.36	0.20%	\$309.55
05/09/06	Sell	\$132.62		(\$37.75)
10/08/07	Buy	\$155.02	0.94%	\$954.60
10/09/07	Sell	\$156.48		\$0.00
10/10/07	Buy	\$156.22	(0.48%)	\$832.00
10/11/07	Sell	\$155.47		(\$1,075.20)
05/05/09	Buy	\$90.57	1.73%	\$1,799.52
05/06/09	Sell	\$92.14		\$0.00
11/17/09	Buy	\$111.34	(0.06%)	\$80.82
11/18/09	Sell	\$111.27		(\$691.46)
08/03/10	Buy	\$112.22	0.67%	\$792.99
08/04/10	Sell	\$112.97		(\$53.46)
02/02/11	Buy	\$130.49	0.22%	\$375.34
02/03/11	Sell	\$130.78		(\$704.72)

No red flags here.

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



With tonight's bullish study the green Aggregator line has risen a little further above 0. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line is very 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 already 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.

Based on the current studies it appears the green Aggregator line is likely to close above zero again on Monday. Of course this could change should new bearish evidence emerge. Meanwhile, the Differential Pivot will be at 1,231.07 on Monday. This is a whopping 4.2% below Friday's close. It is highly unlikely we will see that occur in one day. More probable is that we will need to see a multi-day pullback or consolidation in order for the market to no longer be considered "overbought".

I'm flat now. While we see some signs that the market may continue higher the fact that it is so overbought has me waiting for a more favorable entry point.

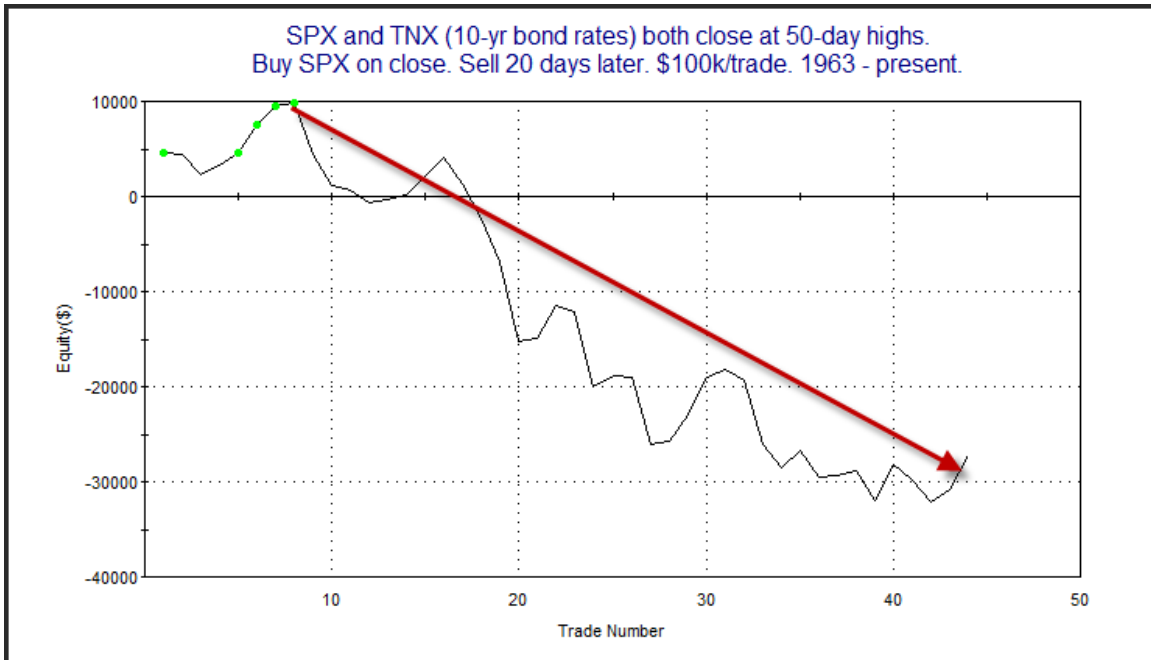
**Intermediate-term Outlook (2 weeks – 2 months)– updated 10/31 – bullish**

With the market hitting new 50-day highs again the intermediate-term picture continues to look fairly strong. I did notice one bearish indication though on Thursday. It came not from the stock market, but from the bond market.

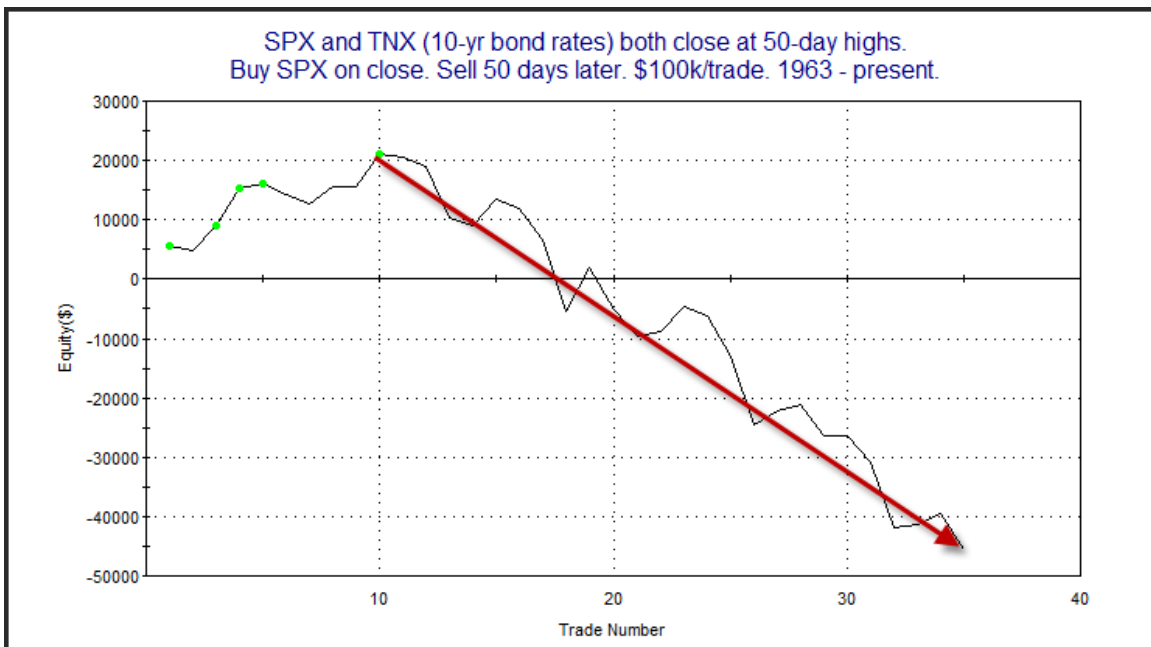
The fact that the 10-year bond rates hit new highs on Thursday along with the SPX is notable. The study below last appeared in the 2/7/11 letter. Stats are updated.

SPX and TNX (10-yr bond rates) both close at 50-day highs. Buy SPX on close. Sell X days later. \$100k/trade. 1963 - 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
50	-45,542.79	35	15	20	42.86	3,202.43	-4,678.96	0.68	0.51	-1,301.22
45	-39,401.07	36	15	21	41.67	3,787.60	-4,581.67	0.83	0.59	-1,094.47
40	-19,283.93	38	18	20	47.37	3,912.18	-4,485.16	0.87	0.79	-507.47
35	-26,508.60	40	18	22	45.00	3,350.01	-3,945.85	0.85	0.69	-662.72
30	-15,725.48	41	17	24	41.46	3,582.60	-3,192.90	1.12	0.79	-383.55
25	-3,159.70	42	19	23	45.24	2,969.29	-2,590.27	1.15	0.95	-75.23
20	-27,184.54	44	23	21	52.27	1,781.90	-3,246.11	0.55	0.60	-617.83
15	-25,104.25	44	23	21	52.27	1,700.03	-3,057.37	0.56	0.61	-570.55
10	-7,819.95	49	29	20	59.18	1,287.83	-2,258.36	0.57	0.83	-159.59
5	-5,191.54	65	35	30	53.85	1,028.57	-1,373.05	0.75	0.87	-79.87

Generally it seems that higher interest rates have often made bonds an attractive investment. This may lead people to forsake stocks in favor of lower risk returns with improved yield. Implications of this study appear to be longer-term in nature than we usually see. To help visualize how this edge has played out over time I have pasted below equity curves using a 20-day and a 50-day exit strategy. First let's examine the 20-day exit strategy equity curve.



Bearish results started appearing around 1965 and they've generally remained bearish ever since. Next is the equity curve for the 50-day exit strategy.

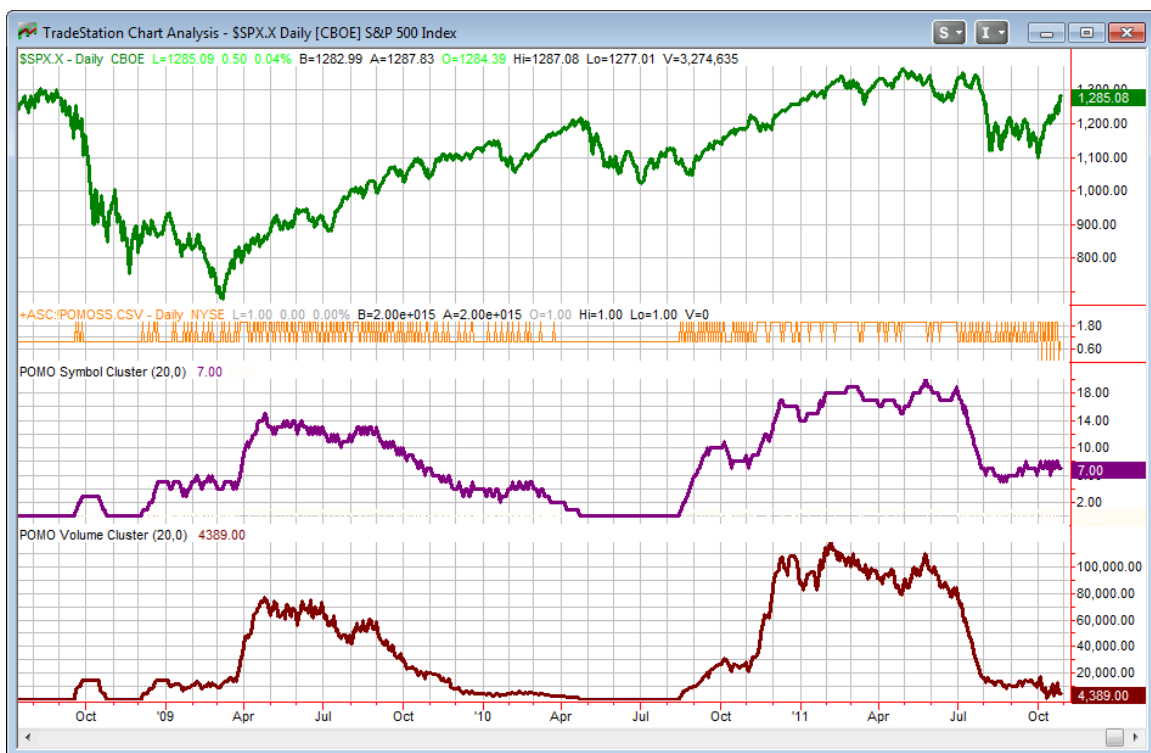


This one looks very similar to the 20-day exit strategy. In this case the downside edge didn't begin to exert itself until the 1970s but it too has persisted lower for a long time.

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 (purple) 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>



Traders need to keep in mind when looking at the chart that both the purple (days) indicator and the maroon (volume) indicator represent net activity. So this past week there were 2 days of buying and 1 day of selling. Fed buying has a positive impact on the indicators, but selling days have a negative impact. So while Operation Twist has generated a large amount of buying and selling activity, it is not a simple liquidity pump

like QE1 and QE2. And while the *net* buying has been weak lately, the market's upward move since the beginning of Operation Twist has been anything but weak.

There is a good amount of evidence now favoring the bulls. Still, the market is very volatile, news-dependent, and overbought. Bond prices are a possible red flag. Aside from that, studies related to breadth, price thrusts and Follow-Through Days all suggest the rally should continue. Overall I am looking for this move higher to persist a while longer. I am still willing to take quick shots on the short side. I will tend to be more aggressive with longs, though, and may look to hold them a bit longer if circumstances allow.

### **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
<b>SPY(1/4)(s)</b>	<b>10/21/2011</b>	<b>\$123.09</b>	<b>\$128.00</b>	<b>-3.99%</b>		<b>covered on open</b>

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.