

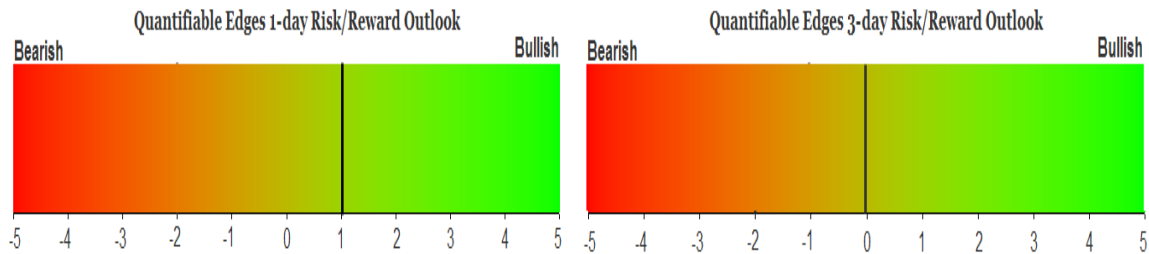
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 1, 2011

Volume 4 Issue 211

Market Overview



Signals Overview

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

Tonight's Research Points

- 1st of the month seasonality appears wishy-washy for Tuesday.
- A sharp drop from a 20-day high is often followed by further selling.
- Unfilled gaps down from 50-day highs used to be followed by more selling on a consistent basis. That has not been the case recently.
- Sharp spikes over > 20% in the VIX as happened Monday are often followed by a 1-day SPX bounce.

Short-term Outlook

The Bottom Line

Evidence appears to be suggesting a moderate upside inclination for Tuesday. The overbought nature of the market is preventing this from generating an outright “long” signal. I am waiting for a more definitive signal to emerge before putting capital at risk.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
November 1, 2011	Unfilled gap to 50-high then inside day	1 day	Bullish	
October 28, 2011	3% gain high volume 10 days	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	
Active - Long Term				
October 30, 2011	SPX & bond yields hit 50-day highs	1-50 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%
Dropped Tonight				
October 31, 2011	Unfilled gap to 50-high then inside day	1 day	Bullish	

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

The Evidence

After a nothing day Friday, Monday saw the market collapse a bit. A gap down in the morning was met with sideways trading for much of the day and then some late-day additional selling. In the end the SPX closed down 2.5%, the Nasdaq lost 1.9%, and the Russell 2000 fell 2.6%. Breadth was extremely weak as the NYSE Up Issues % came in at 19% and the Up Volume % was just 6%. Total volume rose from Friday's levels but was still relatively light.

There is quite a bit to consider tonight. I updated some of the more significant studies, but with the number of things to look at the fact that I am still without power, I skimmed a little and just copied some old studies over. Below is an excerpt from the 10/3/11 subscriber letter. It looked at 1st day of month seasonality. This excerpt does NOT have updated studies.

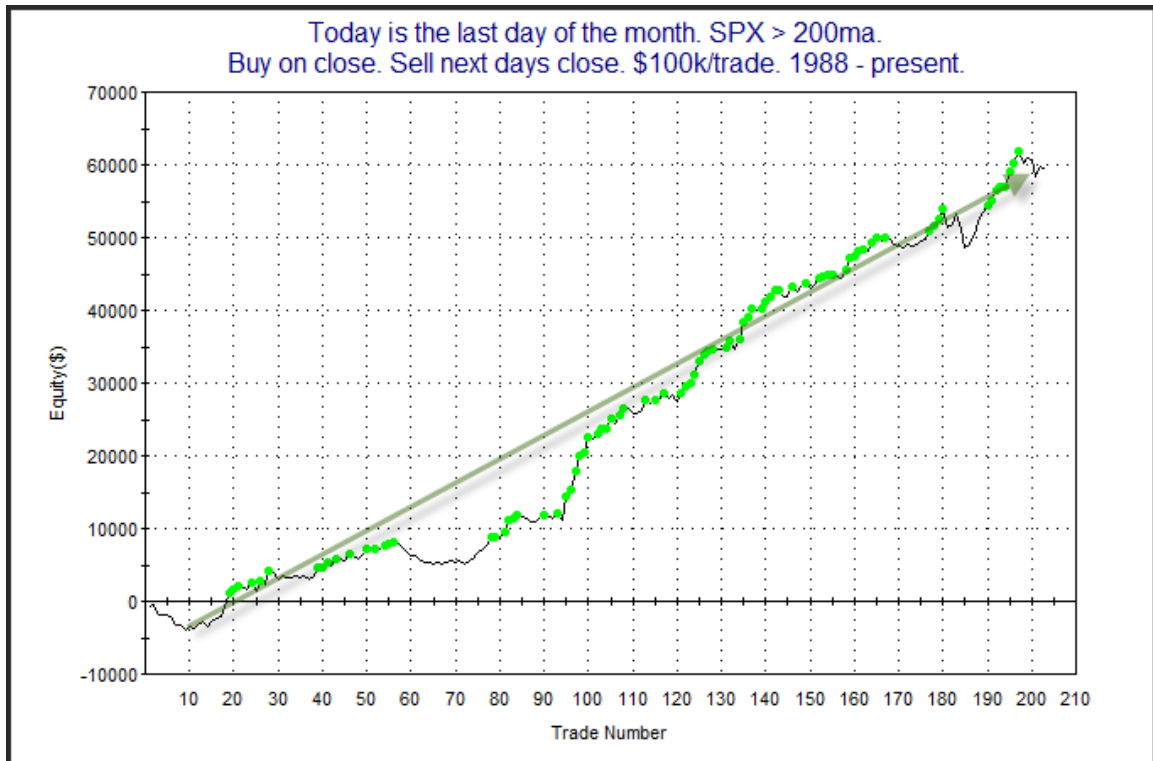
Monday is the 1st trading day of the month. The 1st trading day of the month is renowned for having a bullish tendency, and this has been the case since the late 80s. But this tendency has primarily played out during uptrending markets...Using the 200ma as our measure of uptrend versus downtrend, I will demonstrate this concept below.

This first study shows results since 1988 of committing \$100k per trade on the 1st of the month if the SPX is trading above its 200ma.

Today is the last day of the month. SPX > 200ma.
Buy on close. Sell next days close. \$100k/trade. 1988 - present.

TradeStation Performance Summary Collapse ▲			
All Trades			
Total Net Profit	\$59,414.38	Profit Factor	2.51
Gross Profit	\$98,731.71	Gross Loss	(\$39,317.33)
Total Number of Trades	203	Percent Profitable	62.56%
Winning Trades	127	Losing Trades	76
Even Trades	0		
Avg. Trade Net Profit	\$292.68	Ratio Avg. Win:Avg. Loss	1.50
Avg. Winning Trade	\$777.42	Avg. Losing Trade	(\$517.33)
Largest Winning Trade	\$3,119.10	Largest Losing Trade	(\$2,617.60)

The numbers all look very solid. About 2/3 of the trades were winners, and the winners were about 1.5 times the size of the losers, making for a profit factor of over 2.5. Below is an equity curve that graphically displays the results of this approach.



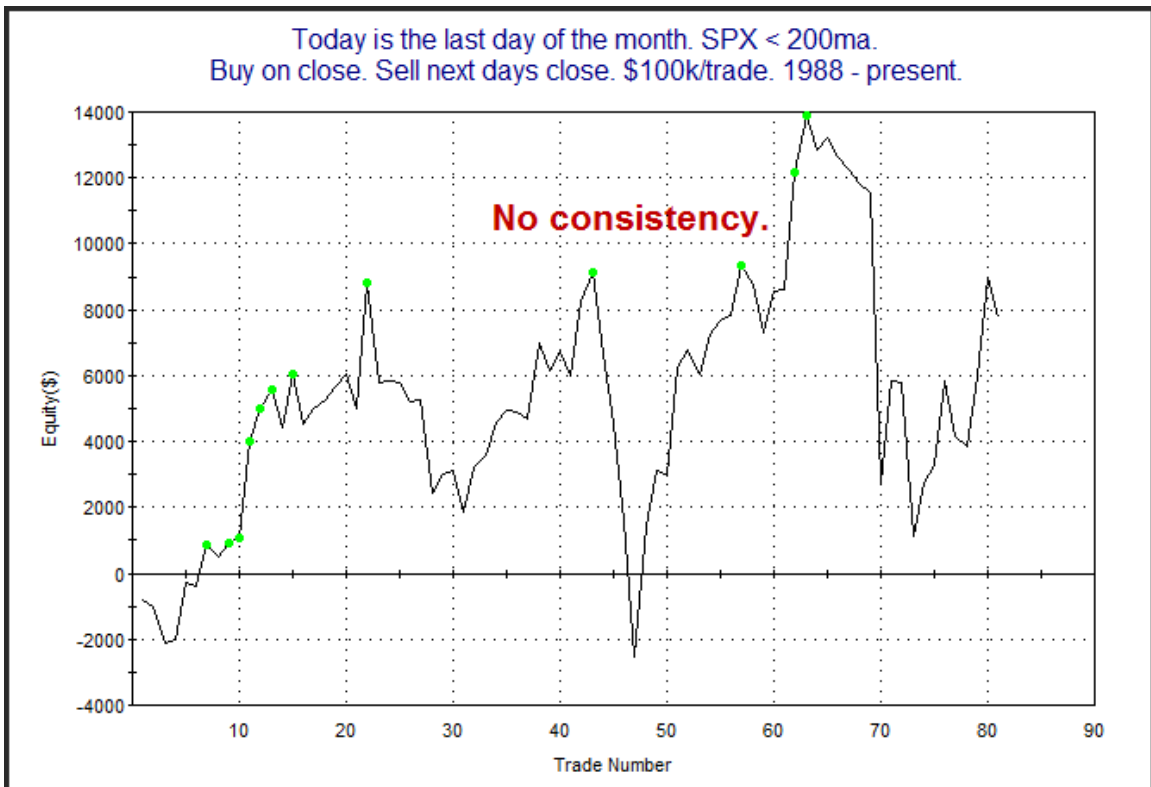
The upward slope is fairly steady and confirms the upside edge.

Next let's look at times like now when the SPX is below its 200ma.

Today is the last day of the month. SPX < 200ma.
Buy on close. Sell next days close. \$100k/trade. 1988 - present.

TradeStation Performance Summary				Collapse ^
All Trades				
Total Net Profit	\$7,768.28	Profit Factor	1.16	
Gross Profit	\$57,627.53	Gross Loss	(\$49,859.25)	
Total Number of Trades	81	Percent Profitable	55.56%	
Winning Trades	45	Losing Trades	36	
Even Trades	0			
Avg. Trade Net Profit	\$95.90	Ratio Avg. Win:Avg. Loss	0.92	
Avg. Winning Trade	\$1,280.61	Avg. Losing Trade	(\$1,384.98)	
Largest Winning Trade	\$3,980.86	Largest Losing Trade	(\$8,883.33)	

The numbers here net out to a positive number, but just barely. It certainly doesn't appear to be anything you would want to base a trade on. Below is an equity curve.



The extremely inconsistent results confirm this setup to be unreliable.

The 1st of the month performance difference has been even more pronounced when the last day of the month has been a big down day. In the 5/3/10 subscriber letter I showed results for times the SPX dropped at least 1% on the last day of the month and it closed above its 200ma. I have updated those results below.

SPX closes down over 1% on the last day of the month. Close > 200ma. Buy on close. Sell next days close. \$100k/trade. 1988 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$8,575.30	Profit Factor	7.93
Gross Profit	\$9,813.13	Gross Loss	(\$1,237.83)
Total Number of Trades	12	Percent Profitable	83.33%
Winning Trades	10	Losing Trades	2
Even Trades	0		
Avg. Trade Net Profit	\$714.61	Ratio Avg. Win:Avg. Loss	1.59
Avg. Winning Trade	\$981.31	Avg. Losing Trade	(\$618.92)
Largest Winning Trade	\$2,225.00	Largest Losing Trade	(\$731.58)

Though the number of instances is low the results are overwhelmingly bullish. But what about times like now when the SPX is in a long-term downtrend? Results for that scenario are below.

SPX closes down over 1% on the last day of the month. Close < 200ma. Buy on close. Sell next days close. \$100k/trade. 1988 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	(\$3,769.99)	Profit Factor	0.72
Gross Profit	\$9,735.07	Gross Loss	(\$13,505.06)
Total Number of Trades	16	Percent Profitable	43.75%
Winning Trades	7	Losing Trades	9
Even Trades	0		
Avg. Trade Net Profit	(\$235.62)	Ratio Avg. Win:Avg. Loss	0.93
Avg. Winning Trade	\$1,390.72	Avg. Losing Trade	(\$1,500.56)
Largest Winning Trade	\$3,980.86	Largest Losing Trade	(\$4,660.72)

I wouldn't go so far as to call this a bearish edge, but there is definitely no upside tendency.

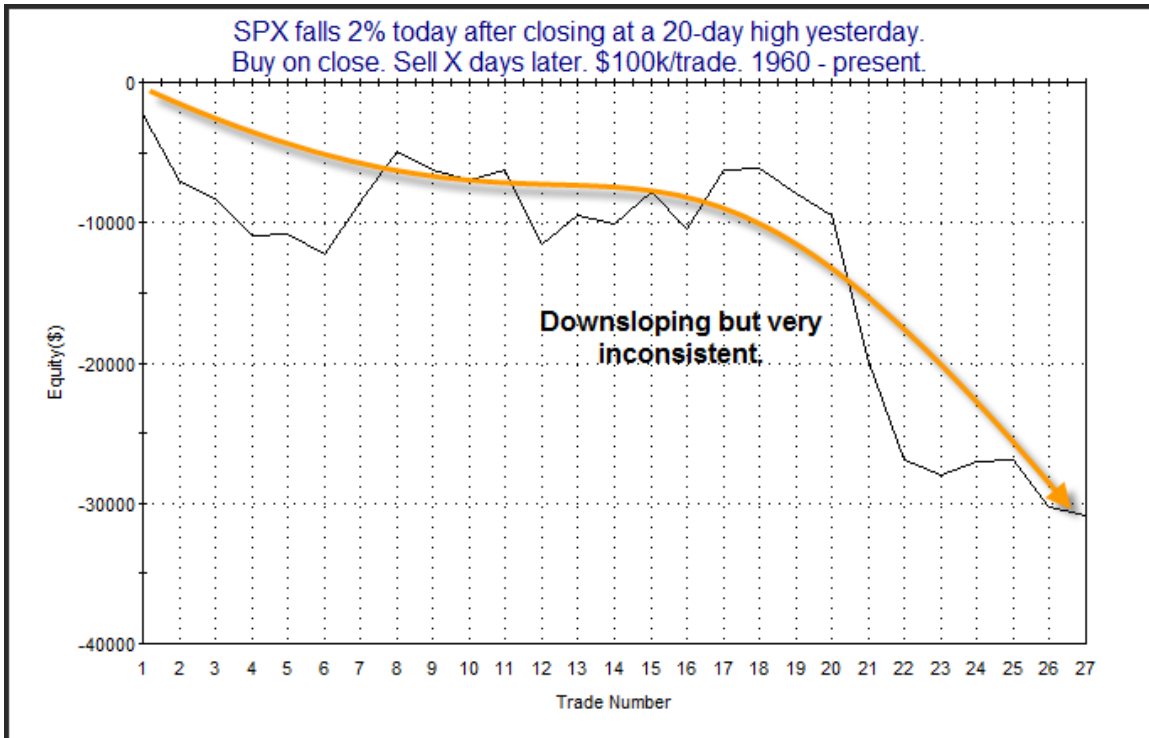
Monday's action just put the SPX below the 200ma from being above it on Friday. And as I showed last year, November has been better than most months in terms of the 1st day of the month. So we very well may see the 1st of the month bullish seasonality play out. It just isn't quite as cut and dry as it often is.

This next excerpt is from the 10/26/11 subscriber letter. These results have also not been updated.

Whether a strong drop like we saw today is reliably followed by a bounce is largely dependent on where the drop initiates. This is something I have covered a large number of times in both the subscriber letter and the blog. In the 4/20/09 subscriber letter I demonstrated this by comparing 2% drops that originate from a 20-day high to those that don't. When a 2% drop does not come immediately after a 20-day high then there is a solid positive expectancy over the next several days. When the 2% drop does come right after a 20-day high...then the expectancy turns negative. The study below is taken from that letter. It looks at the current scenario, and the results have been updated.

SPX falls 2% today after closing at a 20-day high yesterday. Buy on close. Sell X days later. \$100k/trade. 1960 - 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	-52,705.13	27	15	12	55.56	2,070.01	-6,979.61	0.30	0.37	-1,952.04
9	-57,017.76	27	12	15	44.44	2,014.13	-5,412.49	0.37	0.30	-2,111.77
8	-39,077.63	27	11	16	40.74	2,269.69	-4,002.77	0.57	0.39	-1,447.32
7	-26,669.44	27	12	15	44.44	2,043.87	-3,413.06	0.60	0.48	-987.76
6	-29,740.74	27	11	16	40.74	1,467.02	-2,867.37	0.51	0.35	-1,101.51
5	-30,925.79	27	10	17	37.04	1,788.44	-2,871.18	0.62	0.37	-1,145.40
4	-19,958.07	28	9	19	32.14	1,850.14	-1,926.81	0.96	0.45	-712.79
3	-5,979.90	29	12	17	41.38	1,526.52	-1,429.30	1.07	0.75	-206.20
2	-5,099.12	29	11	18	37.93	1,596.21	-1,258.74	1.27	0.77	-175.83
1	528.55	29	17	12	58.62	1,015.03	-1,393.91	0.73	1.03	18.23

Based on the numbers there appears to be a substantial downside edge over the 1st week or two. Much of the edge plays out in the 1st 4-5 days. But below is a profit curve that assumes a 5-day exit strategy.



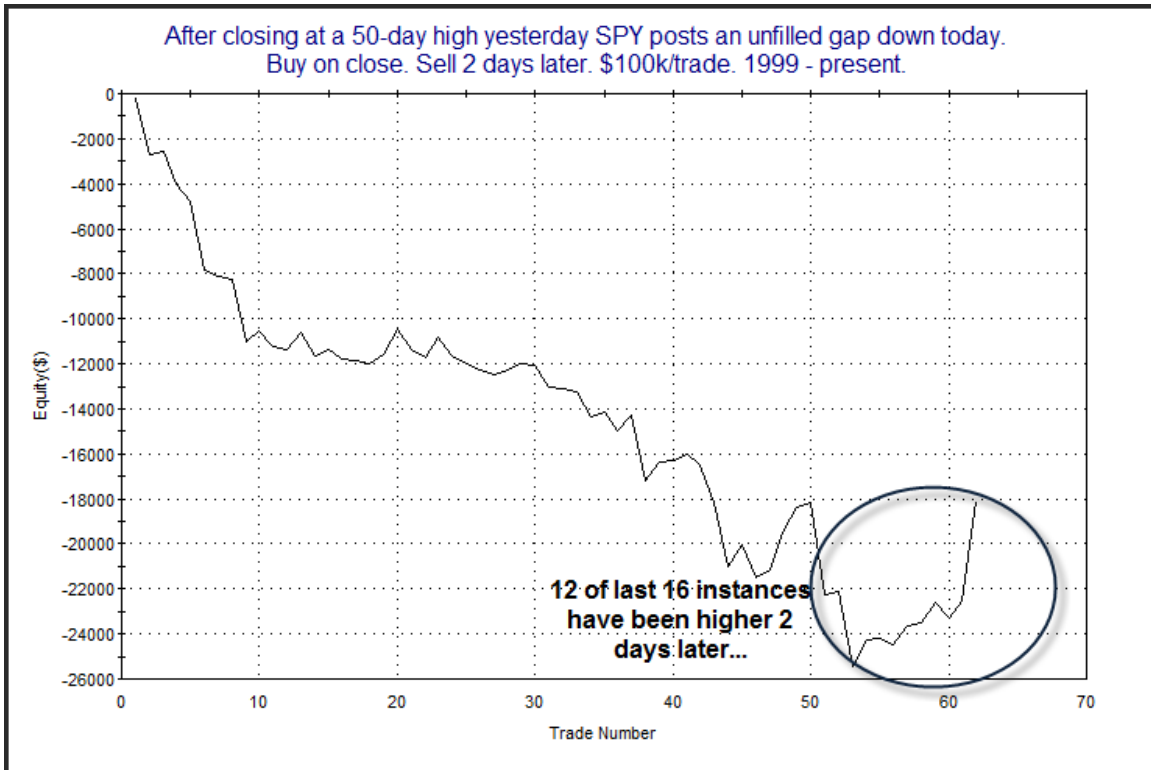
While the curve was never upward sloping, it was also never terribly consistent. I don't believe this study is compelling enough to generate downside expectations from. I do think it drives home the point that a bounce is not typical following this setup.

In the 10/26/11 subscriber letter I also discussed unfilled gaps down from 50-day highs. I have updated that study below.

After closing at a 50-day high yesterday SPY posts an unfilled gap down today.
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	-12,919.70	54	24	30	44.44	1,165.06	-1,362.71	0.85	0.68	-239.25
4	-7,889.41	56	29	27	51.79	960.69	-1,324.06	0.73	0.78	-140.88
3	-8,112.46	57	28	29	49.12	718.46	-973.42	0.74	0.71	-142.32
2	-18,085.26	62	27	35	43.55	713.14	-1,066.86	0.67	0.52	-291.70
1	-9,081.61	62	27	35	43.55	645.02	-757.06	0.85	0.66	-146.48

As you can see the stats appear to suggest another day or two of selling. But the equity curve below is a bit alarming.



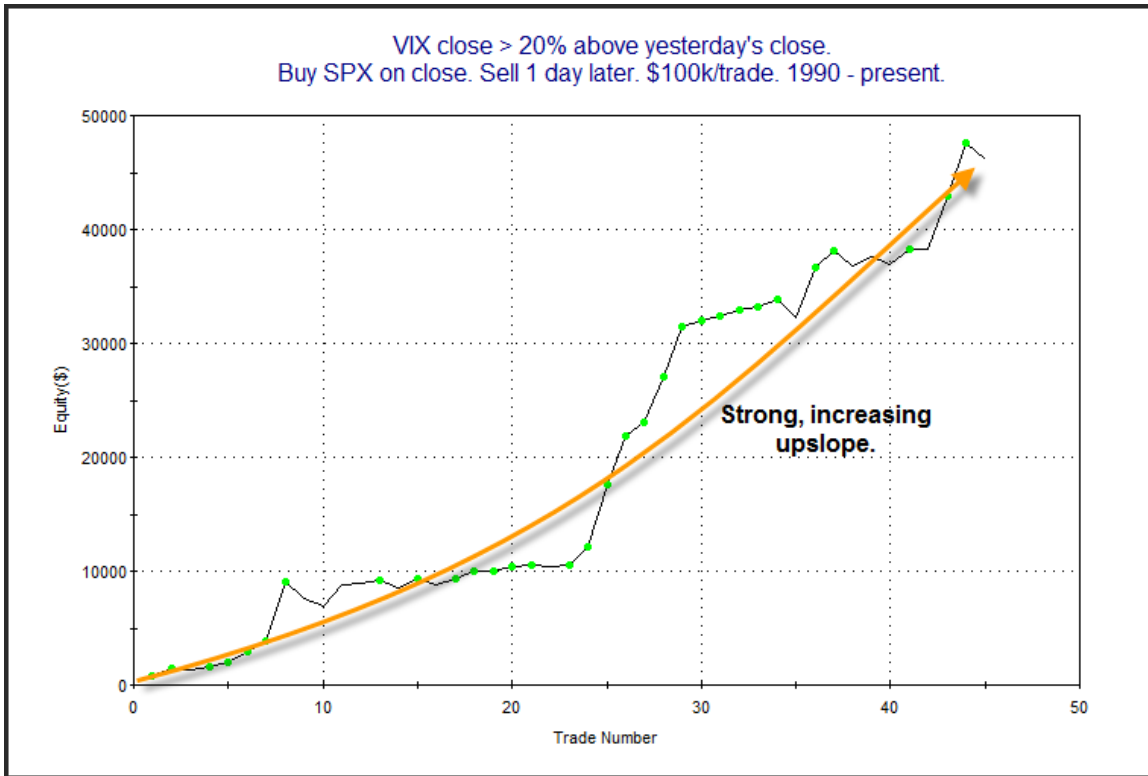
This study appeared to provide a nice short-term bearish edge for a long time. Last week when it triggered I noted I was putting it on probation. The sharp rise following that instance has changed the shape of the curve quite a bit. I have now decided to give this study a rest. Should the bearish edge reassert itself down the road I will look to reinstitute it at that time.

The big spike up in the VIX on Monday triggered the below study. It was last seen in the 8/11/11 letter. Results have been updated.

VIX close > 20% above yesterday's close.
Buy SPX on close. Sell X days later. \$100k/trade. 1990 - 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	42,012.40	41	27	14	65.85	2,601.10	-2,015.51	1.29	2.49	1,024.69
4	46,101.86	43	30	13	69.77	2,560.15	-2,361.75	1.08	2.50	1,072.14
3	28,483.51	43	30	13	69.77	1,877.15	-2,140.85	0.88	2.02	662.41
2	22,139.80	44	26	18	59.09	1,992.77	-1,648.46	1.21	1.75	503.18
1	46,121.87	45	34	11	75.56	1,603.62	-763.76	2.10	6.49	1,024.93

In most cases the upside edge largely played out on day 1. Below is an equity curve assuming a 1-day exit.



Of all the studies I examined tonight I would say this is the most compelling. Unfortunately, the edge is quite short-term. I did decide to include it in the Aggregator calculation.

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 rose quite a bit but is still 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 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.

There is only 1 active study with expectations reaching beyond Tuesday. This means that the value of the green Aggregator line Tuesday and beyond will be highly dependent on market action and which studies are subsequently triggered. Meanwhile, the Differential Pivot will be inverted and up at 1,279.97 on Tuesday. This over 2.1% above Monday's close. So without a sharp rally of greater than this amount on Tuesday, the Differential Line will rise above 0 and the SPX will be considered "oversold".

Bottom line is that I think Tuesday has a pretty good shot at a rally. Between the VIX spike, the 1st of the month, and the already open bullish studies from the past few days there seems to be more suggesting a rise than a further drop. While it is not a trade idea I would track in the Subscriber Letter, I would consider buying into early weakness for a

daytrade on Monday. Beyond tomorrow is not as clear. For that I will be monitoring market action closely. Subscribers may want to check out the intraday Quantifinder tomorrow afternoon to see what studies appear to be emerging. Rather than try and anticipate too much tonight, I will wait another day before publishing any new trade ideas in the letter.

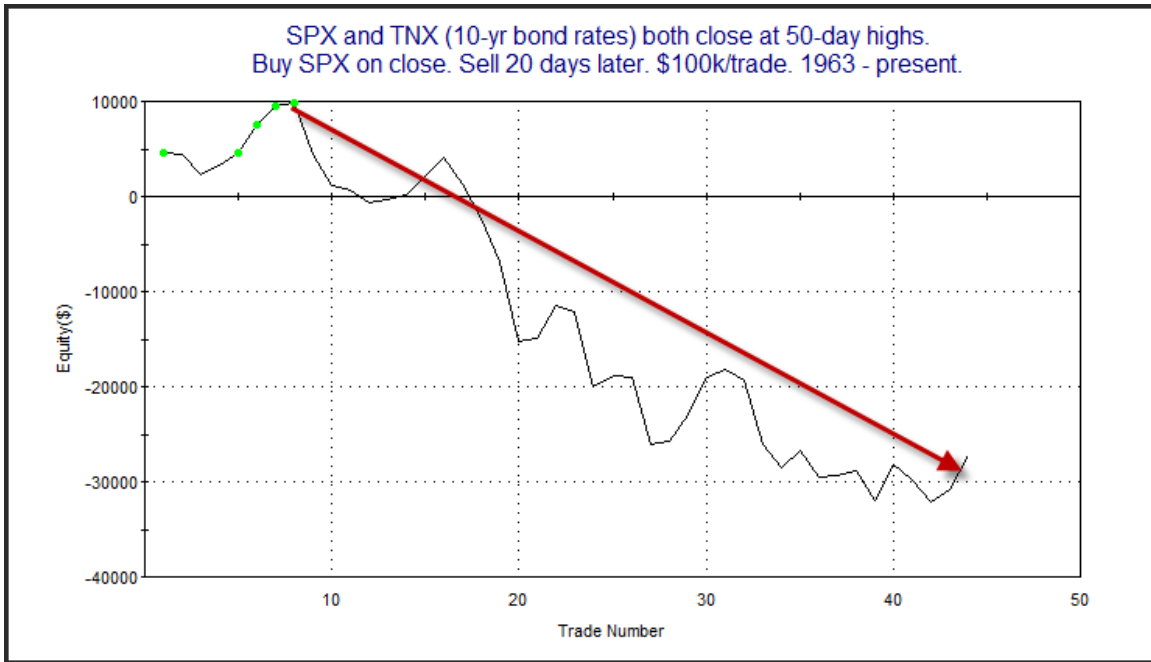
Intermediate-term Outlook (2 weeks – 2 months)– updated 10/31 – bullish

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.

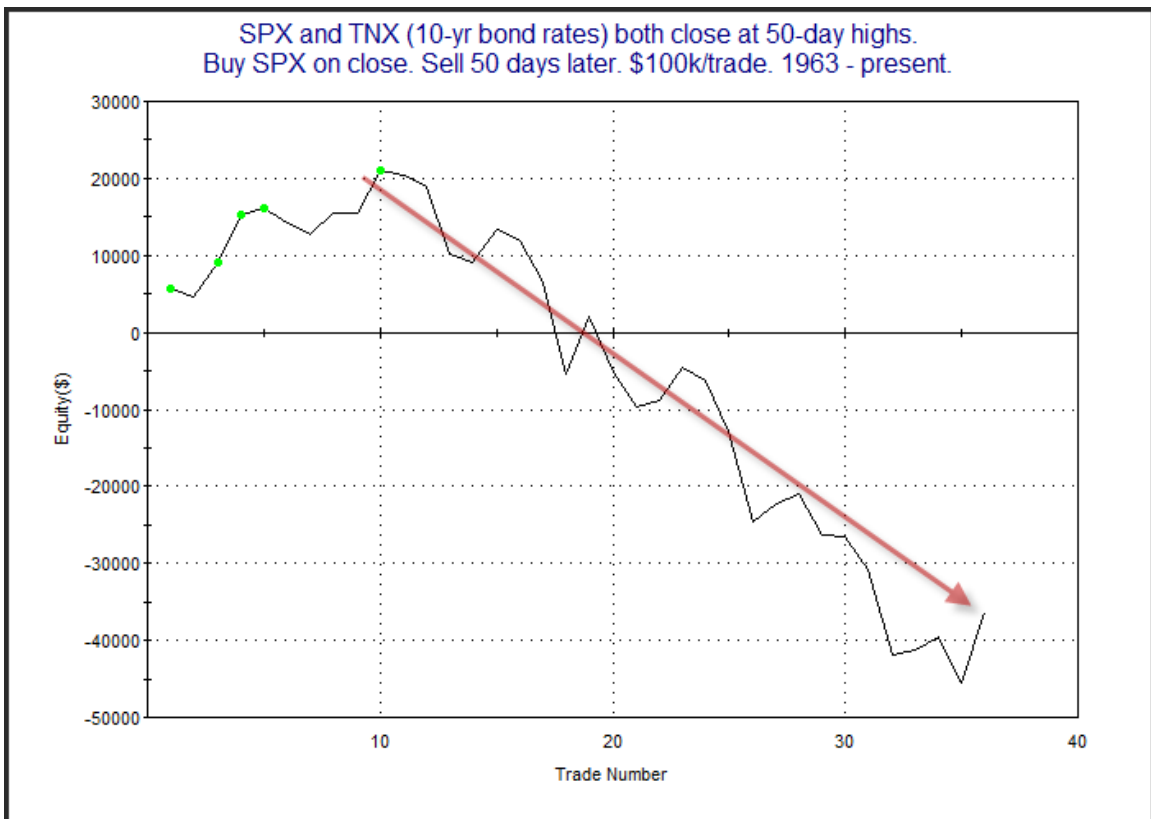
The fact that the 10-year bond rates hit new highs on Thursday along with the SPX is notable. The study below last appeared in the 2/7/11 letter. Stats are updated.

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.

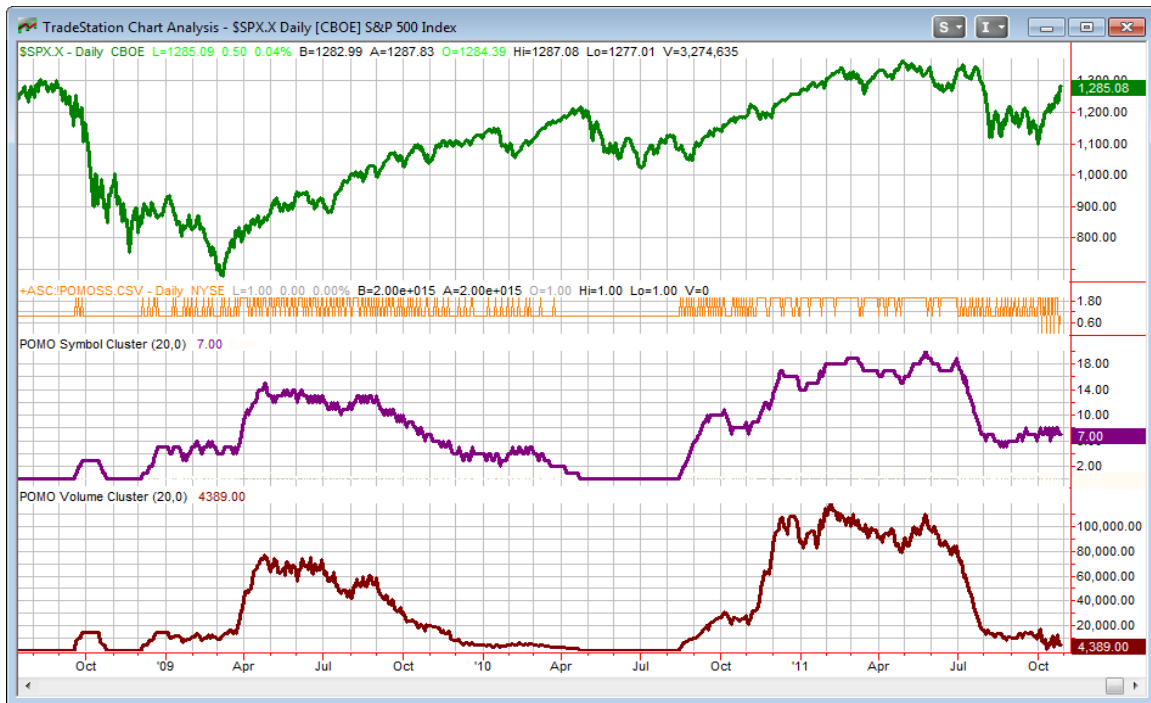


This one looks very similar to the 20-day exit strategy. In this case the downside edge didn't begin to exert itself until the 1970s but it too has persisted lower for a long time.

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 3rd 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

None

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