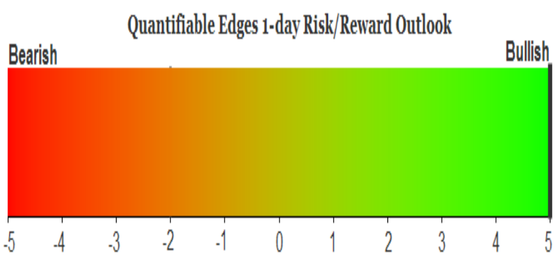
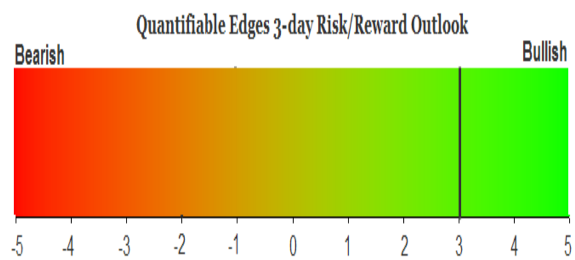
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 2, 2011 Volume 4 Issue 212

Market Overview





Signals Overview

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

Tonight's Research Points

- Back to back days of very weak breadth have suggested a strong, reliable bounce in the past.
- Multiple selloffs > 1.75% without a 10-day low also have suggested a bounce is likely.
- Fed Days have historically been positive. This is especially true when they are preceded by strong selling.

Short-term Outlook
The Bottom Line

Evidence is now strongly bullish over the next couple of days and the market is very oversold. Conditions appear ripe for a bounce. I will be looking to get long and take advantage of the anticipated bounce.

Hanna Capital Management, LLC 16 Hillcrest Rd., Medfield, Massachusetts 02052 781-956-6952

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
November 2, 2011	1% drop before a Fed Day	1 day	Bullish	
November 2, 2011	2 strong down days	1-2 days	Bullish	3.00%
October 28, 2011	Double 90% breadth & 50-day high	1-4 days	Bullish	
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				
November 1, 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	***Gap -n- go***	***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

More strong selling hit the market on Tuesday. The SPX fell 2.8%, the Nasdaq declined 2.9%, and the Russell 2000 dropped 3.7%. Breadth was again extremely weak as the NYSE Up Issues % came in at 15% and the Up Volume % was 6%. Volume increased as recent buyers appeared to panic out of positions.

When the market sells off as hard as it has over the last 2 days that normally is enough to wash out the sellers and lead to a quick bounce. The fact that it is happening right before a Fed Day seems to be a very fortuitous time. Let's look at the 2-day washout a few different ways and then I'll discuss Fed Day implications.

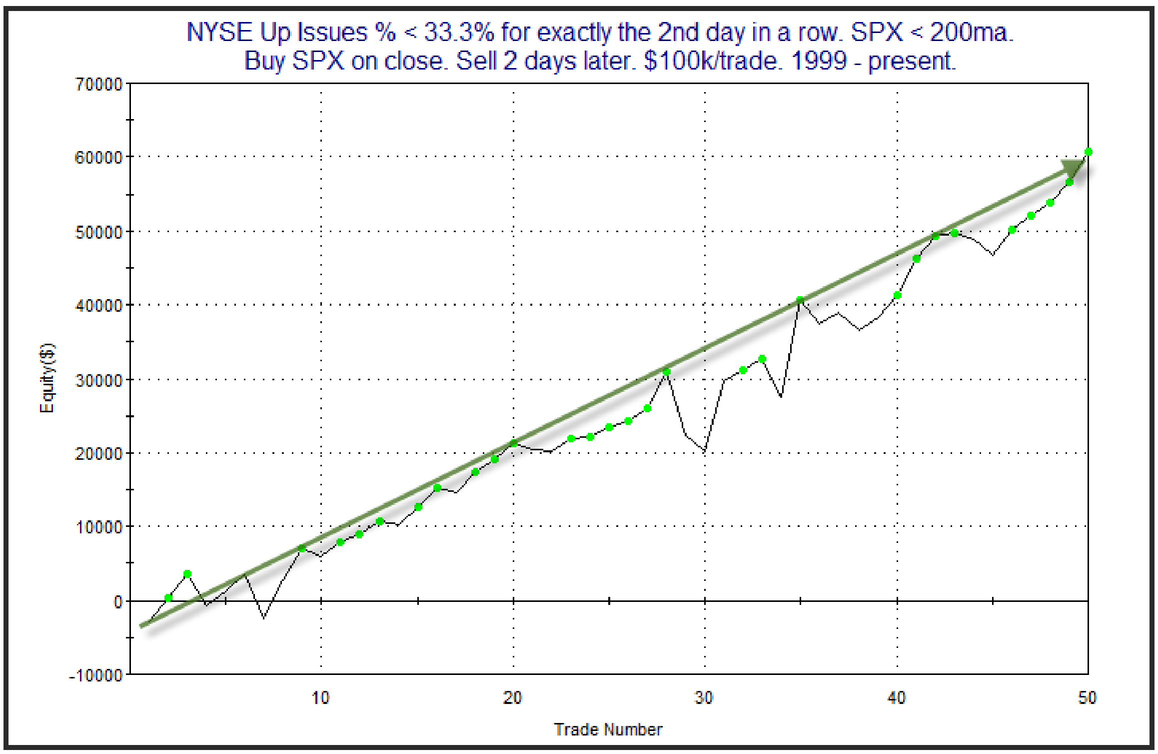
The study below was last seen in the 10/4/11 subscriber letter. It is one that I have shown many times over the last few years, and it has been incredibly dependable. The study looks for two days of strongly lopsided negative breadth and a close under the 200ma. I have updated the statistics.

NYSE Up Issues % < 33.3% for exactly the 2nd day in a row. SPX < 200ma.
Buy SPX 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	65,823.54	44	32	12	72.73	3,174.52	-2,980.10	1.07	2.84	1,495.99
4	42,627.53	47	29	18	61.70	3,130.50	-2,675.38	1.17	1.89	906.97
3	49,424.66	50	31	19	62.00	3,596.01	-3,265.88	1.10	1.80	988.49
2	60,767.77	50	35	15	70.00	2,907.33	-2,732.59	1.06	2.48	1,215.36
1	41,584.42	50	33	17	66.00	2,016.40	-1,468.05	1.37	2.67	831.69

48 of 50 instances (96%) closed above the entry price at some point in th enext week. 49 of 50 did so within 6 trading days.

For the considerable sample size and low number of criteria these results are astonishingly consistent. The stat at the bottom of the table is what seems most striking. Below is an equity curve using a 2-day exit.



As I've mentioned in the past I especially like this study because it has produced such consistently positive returns in a downtrending environment. That's fairly unusual to see.

But breadth the last two days was well below the 33% threshold. Therefore I decided to examine the results under even more extreme conditions. This test is the same as the one above except I lowered the threshold from 33% to 20%.

NYSE Up Issues % < 20% for exactly the 2nd day in a row. SPX < 200ma.
Buy SPX 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	54,353.93	8	8	0	100.00	6,794.24	0.00	100.00	100.00	6,794.24
4	40,975.74	8	7	1	87.50	6,679.93	-5,783.80	1.15	8.08	5,121.97
3	27,226.69	8	6	2	75.00	6,263.33	-5,176.65	1.21	3.63	3,403.34
2	22,650.88	8	7	1	87.50	4,468.84	-8,631.00	0.52	3.62	2,831.36
1	21,114.93	8	7	1	87.50	3,177.70	-1,129.00	2.81	19.70	2,639.37

While instances are a little low the numbers are astounding. A week out all eight instances were trading higher and the average gain was close to 7%. As you might suspect with gains this large there was a fair amount of variance. Below I have listed all 8 instances.

NYSE Up Issues % < 20% for exactly the 2nd day in a row. SPX < 200ma.
Buy SPX on close. Sell 5 days later. $100k/trade. 1999 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
07/23/02	Buy	$797.70	13.17%	$14,013.75
07/30/02	Sell	$902.78		($2,752.50)
08/15/07	Buy	$1,406.70	4.08%	$4,129.36
08/22/07	Sell	$1,464.07		($2,563.10)
03/17/08	Buy	$1,276.60	5.98%	$6,480.24
03/25/08	Sell	$1,352.98		$0.00
10/07/08	Buy	$996.23	0.18%	$4,808.00
10/14/08	Sell	$998.01		($15,643.00)
11/06/08	Buy	$904.88	0.71%	$5,177.70
11/13/08	Sell	$911.29		($9,480.90)
11/20/08	Buy	$752.44	19.11%	$18,982.92
11/28/08	Sell	$896.24		($1,453.32)
09/22/11	Buy	$1,129.56	2.73%	$5,834.40
09/29/11	Sell	$1,160.40		($721.60)
10/03/11	Buy	$1,099.23	8.70%	$8,611.20
10/10/11	Sell	$1,194.89		($2,201.40)

I would be a little surprised to see the market again close to 7% in the next week, but the potential for a sizable bounce is certainly there.

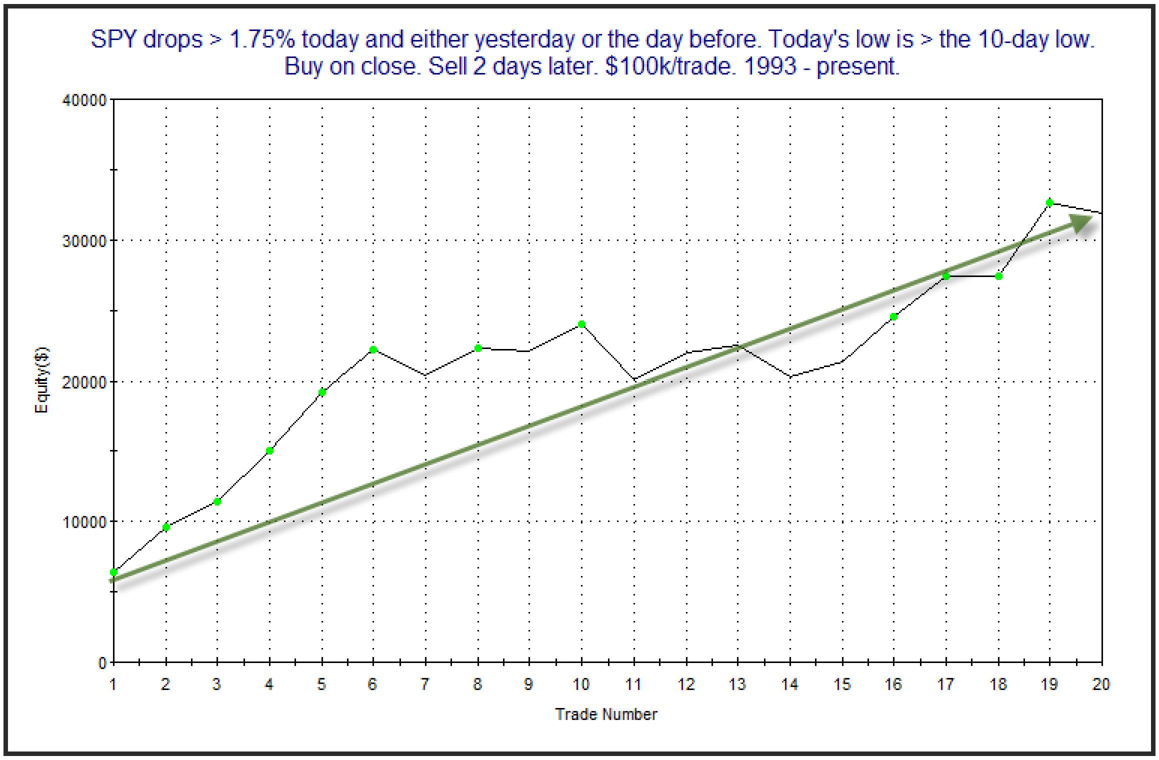
Another study that triggered tonight simply looked at the strong price drops over the last two days. It also appeared fairly recently, and was last seen in the 10/3/11 subscriber letter. Results are all updated below.

SPY drops > 1.75% today and either yesterday or the day before. Today's low is > the 10-day low.
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
10	25,159.08	17	11	6	64.71	6,085.56	-6,963.68	0.87	1.60	1,479.95
9	35,521.81	17	13	4	76.47	5,234.66	-8,132.20	0.64	2.09	2,089.52
8	27,507.17	17	12	5	70.59	4,417.88	-5,101.48	0.87	2.08	1,618.07
7	22,660.63	17	12	5	70.59	3,814.04	-4,621.58	0.83	1.98	1,332.98
6	21,969.81	18	12	6	66.67	3,756.25	-3,850.87	0.98	1.95	1,220.55
5	20,227.19	18	12	6	66.67	3,266.56	-3,161.93	1.03	2.07	1,123.73
4	14,580.42	19	13	6	68.42	3,604.70	-5,380.11	0.67	1.45	767.39
3	18,190.79	19	14	5	73.68	2,824.58	-4,270.66	0.66	1.85	957.41
2	31,879.25	20	15	5	75.00	2,716.62	-1,774.01	1.53	4.59	1,593.96
1	20,193.38	22	17	5	77.27	1,796.80	-2,070.45	0.87	2.95	917.88

21 of 22 instances (95%) closed above the entry price
at some point in the next 3 days.

Here again we see what appears to be a strong and consistent tendency to bounce over the next 1-2 days. Below I have produced an equity curve assuming a 2-day holding period.



Compared to the first study, there is a bit more wiggle in this equity curve. Even so the upside tendency appears evident.

One metric I used in the Quantifiable Edges Guide to Fed Days is the SPY closing range on the day before the Fed Day. Essentially, the closer SPY finishes to the bottom of its range, the more bullish the Fed Day. The study below was last seen in the 9/21/11 letter. I have updated all results.

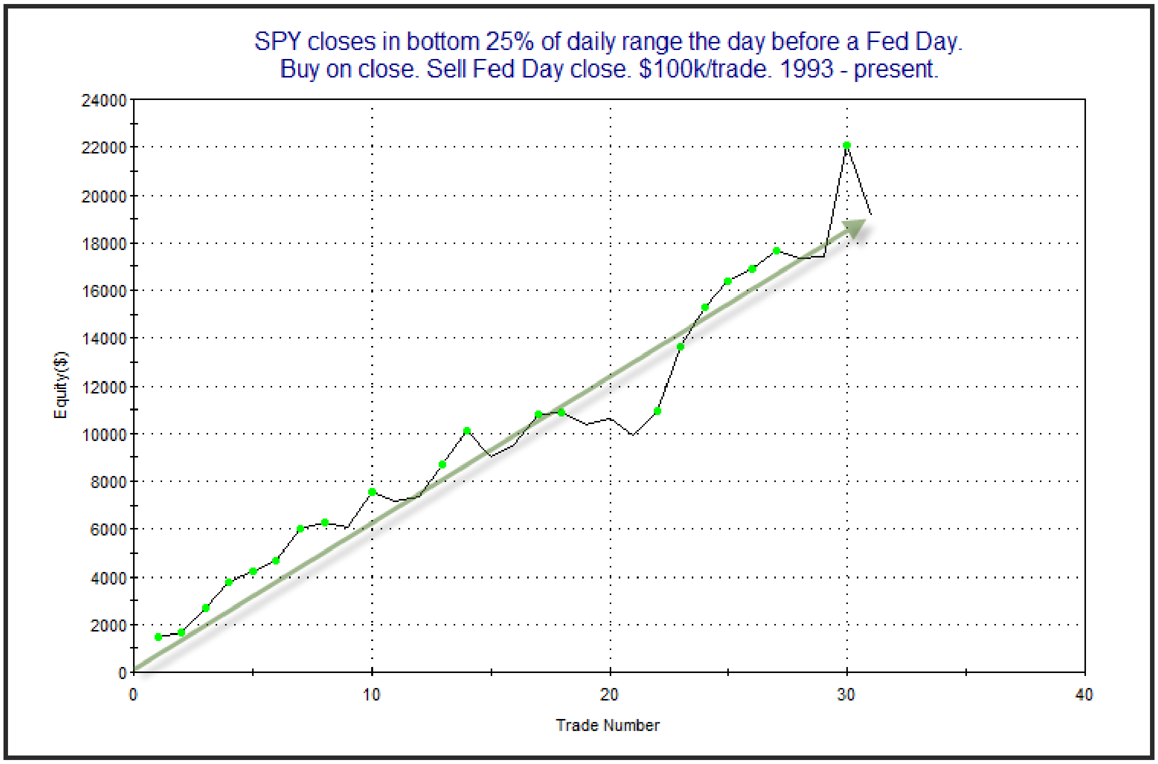
SPY closes in bottom 25% of daily range the day before a Fed Day.
Buy on close. Sell Fed Day close. $100k/trade. 1993 - present.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$19,112.26	Profit Factor	4.07
Gross Profit	$25,333.83	Gross Loss	($6,221.57)
Total Number of Trades	31	Percent Profitable	77.42%
Winning Trades	24	Losing Trades	7
Even Trades	0		
Avg. Trade Net Profit	$616.52	Ratio Avg. Win:Avg. Loss	1.19
Avg. Winning Trade	$1,055.58	Avg. Losing Trade	($888.80)
Largest Winning Trade	$4,645.80	Largest Losing Trade	($2,945.28)

The sample size is ample and the stats appear overwhelmingly bullish. Below is an equity curve to see how the edge has played out over time.



The last instance was the biggest failure of the bunch. Even so, it did little more than bring the profit curve back toward its' strongly upsloping trendline.

More compelling than the fact that SPY closed in the lower end of its range is that it underwent a sharp selloff immediately prior to the Fed Day. While Fed Days have historically provided an upside edge, that edge has been substantially more powerful when there has been strong selling the day before. The last time I showed this study was in the 6/23/10 Subscriber Letter. I've updated the statistics below.

SPY drops at least 1% the day before a Fed Day.
Buy on close. Sell Fed Day close. $100k/trade. 3/1/93 - present.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$20,087.75	Profit Factor	11.03
Gross Profit	$22,090.62	Gross Loss	($2,002.87)
Total Number of Trades	16	Percent Profitable	75.00%
Winning Trades	12	Losing Trades	4
Even Trades	0		
Avg. Trade Net Profit	$1,255.48	Ratio Avg. Win:Avg. Loss	3.68
Avg. Winning Trade	$1,840.88	Avg. Losing Trade	($500.72)
Largest Winning Trade	$4,704.07	Largest Losing Trade	($1,141.01)

Instances are a bit low, but they couldn't get much more bullish. With a profit factor over 10 and the average trade about as positive as the worst trade was negative, risk/reward appears to heavily favor the bulls. Below I have listed all occurences for those that would like to take a better look.

SPY drops at least 1% the day before a Fed Day. Buy on close. Sell Fed Day close. $100k/trade. 3/1/93 - present.				
Date/Time	**Signal**	**Price**	**% Profit**	**Run-up Drawdown**
12/18/95	Buy	$60.63	1.07%	$1,187.28
12/19/95	Sell	$61.28		($82.45)
12/16/96	Buy	$72.56	0.54%	$992.16
12/17/96	Sell	$72.95		($937.04)
12/10/01	Buy	$114.38	(0.20%)	$1,171.16
12/11/01	Sell	$114.15		($419.52)
01/29/02	Buy	$110.28	1.44%	$2,817.66
01/30/02	Sell	$111.87		($1,703.28)
05/06/02	Buy	$105.47	(0.35%)	$805.80
05/07/02	Sell	$105.10		($540.36)
06/25/02	Buy	$97.56	0.16%	$604.75
06/26/02	Sell	$97.72		($2,429.25)
12/09/02	Buy	$89.50	1.34%	$1,787.20
12/10/02	Sell	$90.70		$0.00
01/27/04	Buy	$114.68	(1.14%)	$522.60
01/28/04	Sell	$113.37		($1,515.54)
03/15/04	Buy	$111.20	0.53%	$773.14
03/16/04	Sell	$111.79		($323.64)
03/17/08	Buy	$128.30	4.15%	$4,198.81
03/18/08	Sell	$133.63		$0.00
09/15/08	Buy	$120.09	1.67%	$1,855.36
09/16/08	Sell	$122.10		($2,570.88)
12/15/08	Buy	$87.75	4.71%	$4,863.53
12/16/08	Sell	$91.88		$0.00
08/11/09	Buy	$99.73	1.07%	$1,833.66
08/12/09	Sell	$100.80		($220.44)
04/27/10	Buy	$118.48	0.76%	$1,012.80
04/28/10	Sell	$119.38		($177.24)
06/22/10	Buy	$109.57	(0.31%)	$419.52
06/23/10	Sell	$109.23		($994.08)
08/08/11	Buy	$112.26	4.65%	$4,788.20
08/09/11	Sell	$117.48		($1,771.10)

So it appears the Tuesday selloff may have provided a favorable buying opportunity. I often take exposure at the close prior to a Fed Day, because there has been tendency over the years for them to gap up in the morning. The after-hours is currently pointing that way, but of course anything can happen between now and the open - especially with the current environment so Europe-news dependent.

A couple of other points regarding Fed Days that I illustrated in the Guide were that: 1) Gaps down of basically any size have a strong tendency to fill the gap and show a positive return at some point before the Fed announcement. (Some of the research in this area was provided courtesy of Scott Andrews of www.MasterTheGap.com .) 2) The upside edge provided by Fed Days typically played itself out prior to the 2:15 announcement. Traders may want to keep these facts in mind as they plan their day tomorrow. ***Note: The FOMC announcement for Wednesday is scheduled for 12:30 rather than 2:15 as was done in the past.***

I have updated the Aggregator chart below.

With tonight's bullish studies the green Aggregator line has risen 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 posted a huge spike and is now strongly above 0. A positive Differential reading means the SPX has underperformed expectations over the last few days. So net expectations are positive and the SPX is strongly oversold versus recent expectations. Historically this has proved to be a bullish combination. Bullish configurations such as this are visible on the chart whenever both lines close above 0. Due to this the Aggregator System changed from flat to long at the close.

While evidence of an upside edge is fairly strong, it only looks out a couple of days. This means that the value of the green Aggregator line will continue to be highly dependent on market action and which studies are subsequently triggered. Meanwhile, the Differential Pivot will be 1,284.38 on Wednesday. This about 5.4% above Tuesday's close. It is highly unlikely that a rally of this size will be achieved in just one day. Therefore we are now looking for a multi-day rally to flip the Differential Line back to negative.

Everything I am looking at tonight is telling me the market should bounce and the timing should be almost immediate. I'll be looking to take on exposure fairly aggressively, but I will also be looking to take partial profits fairly quickly.

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

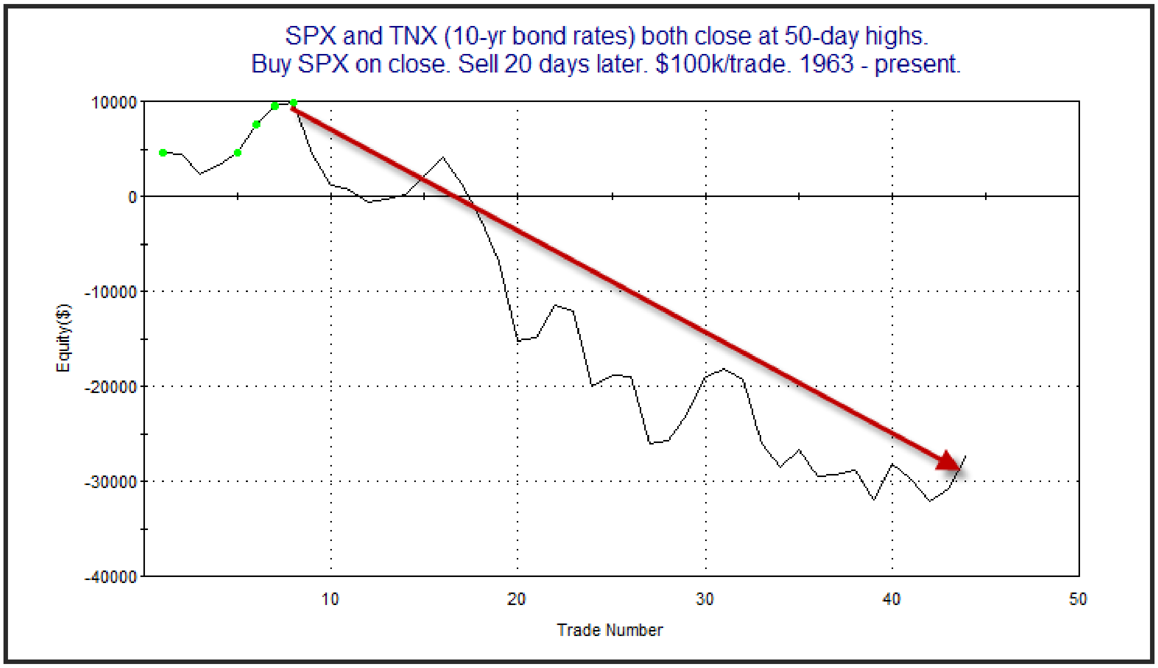
With the market hitting new 50-day highs again the intermediate-term picture continues to look fairly strong. I did notice one bearish indication though on Thursday. It came not from the stock market, but from the bond market.

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.

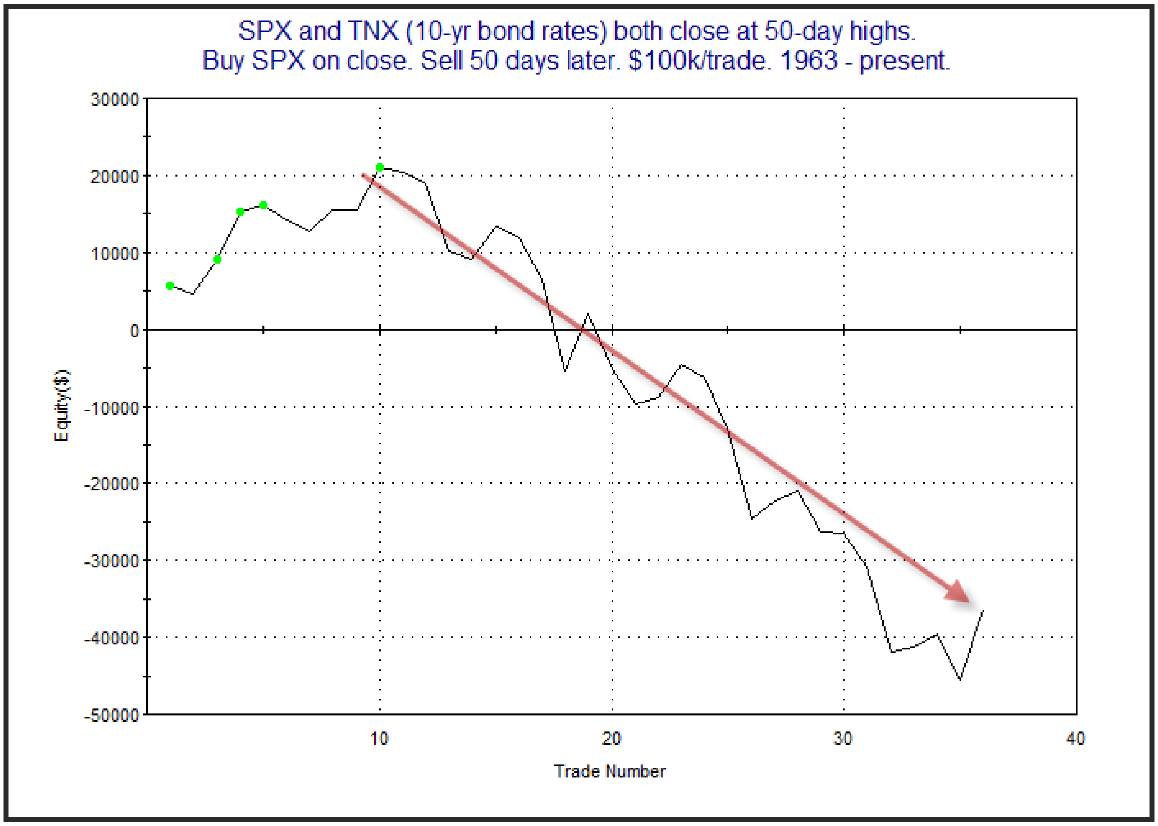
SPX and TNX (10-yr bond rates) both close at 50-day highs.
Buy SPX on close. Sell X days later. $100k/trade. 1963 - present.

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.

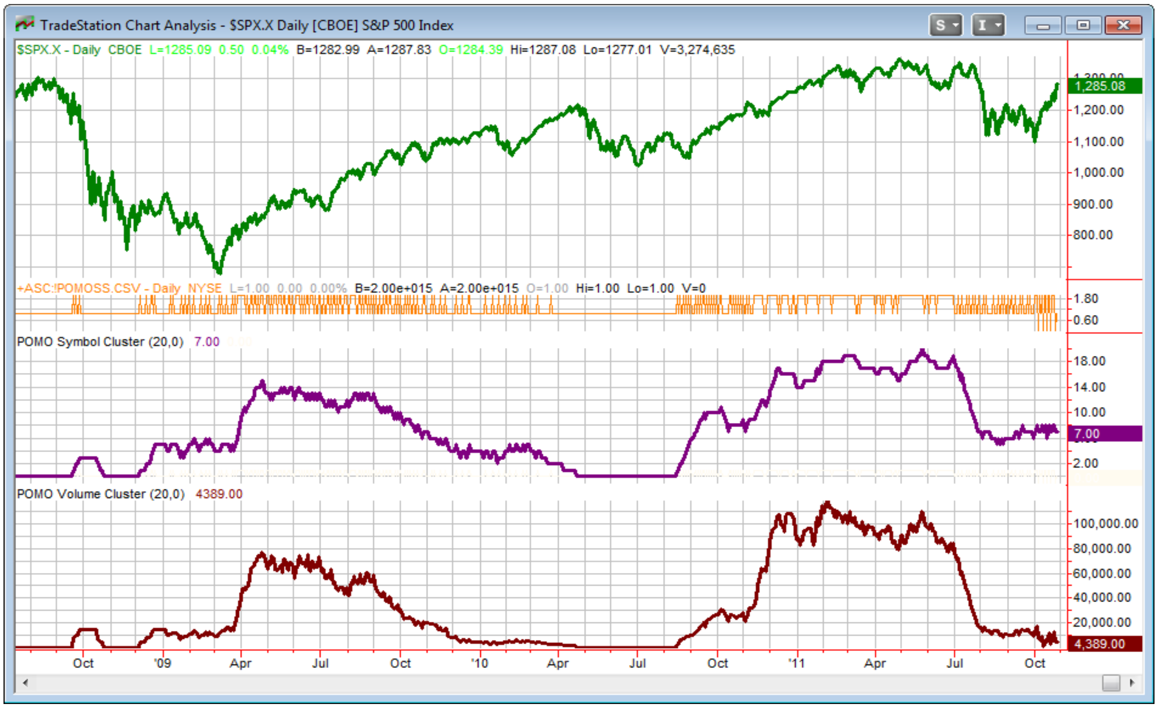


This one looks very similar to the 20-day exit strategy. In this case the downside edge didn't begin to exert itself until the 1970s but it too has persisted lower for a long time.

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.

.

Note: The FOMC announcement is scheduled for 12:30pm today, not the normal 2:15pm.

SPY – buy ¼ index position @ $122.25 limit. Based on the short-term outlook above. If the market gaps up I will not wait for it to completely fill that gap before entering. The entry price here is $0.25 above Tuesday's close. **If this trade idea is not filled by 12:00pm EST, it will be cancelled and then re-entered as a LIMIT ON CLOSE order.** I do not want to get filled on some post-announcement selloff, but if the selling persists until the closing bell I will look to buy at that time.

SPY – buy ¼ index position @ $121.70 limit. If not filled by 10am, CANCEL. I would look to take on additional exposure if there is early morning weakness, either with a gap down, or within the 1st half hour of trading. **If this position is filled, I WILL SELL IT AT 12:15pm PRIOR TO THE ANNOUNCMENT.**

Current Open Trade Ideas

None