

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 7, 2011

Volume 4 Issue 215

Market Overview



Signals Overview

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

Tonight's Research Points

- Positive action in the SOX despite the selloff in the Nasdaq suggests Monday could be an up day.

Short-term Outlook

The Bottom Line

There is limited short-term evidence pointing to an up day on Monday. With the market short-term overbought I am not looking to enter yet, but most likely will if we get selling early in the week.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
November 7, 2011	SOX up 1%. Nasdaq down.	1 day	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 3, 2011	Unfilled Gap & Close > Open Fed Day	1-2 days	Bearish	-1.60%

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

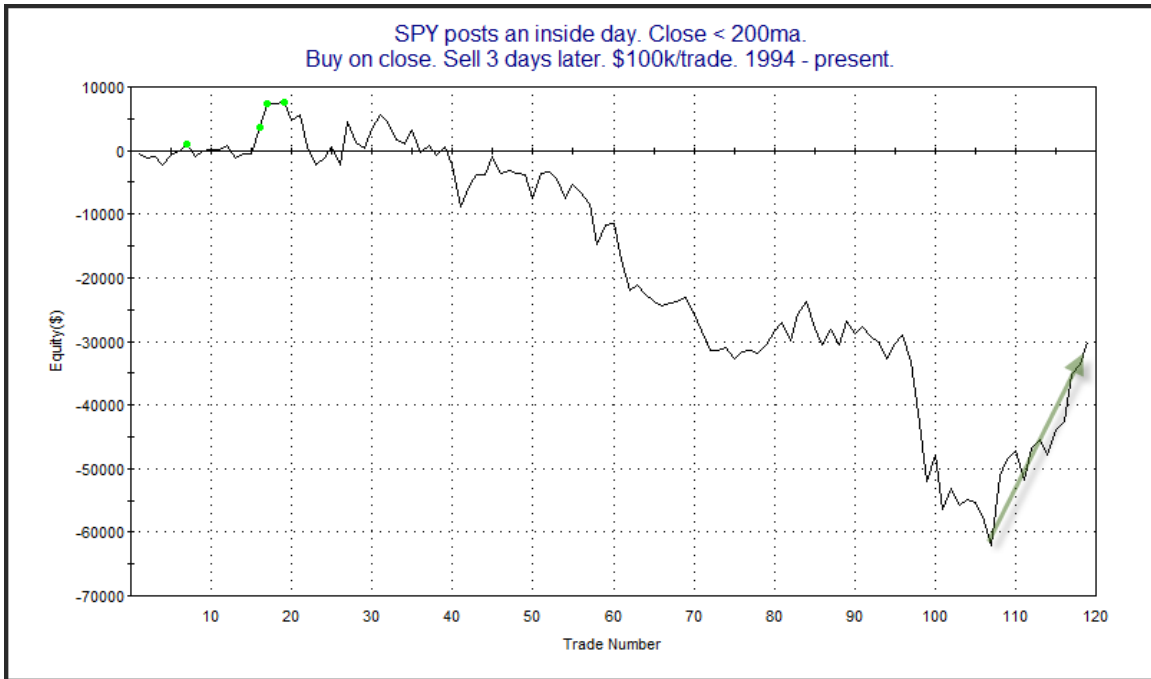
The Evidence

Early news out of Europe sent futures lower before the open and the employment report failed to inspire buying for more than 5 minutes. So the market opened weakly, with the major indices all gapping lower. It continued to sell off for much of the morning but then turned around. It climbed through most of the afternoon and closed near its high, but still did not manage to make it into positive territory. The SPX ended down 0.6%, the Nasdaq lost 0.4%, and the Russell 2000 dropped 0.7%. Breadth was moderately weak as the NYSE Up Issues % came in at 39% and the Up Volume % was 36%. Total NYSE volume declined a bit from Thursday's level.

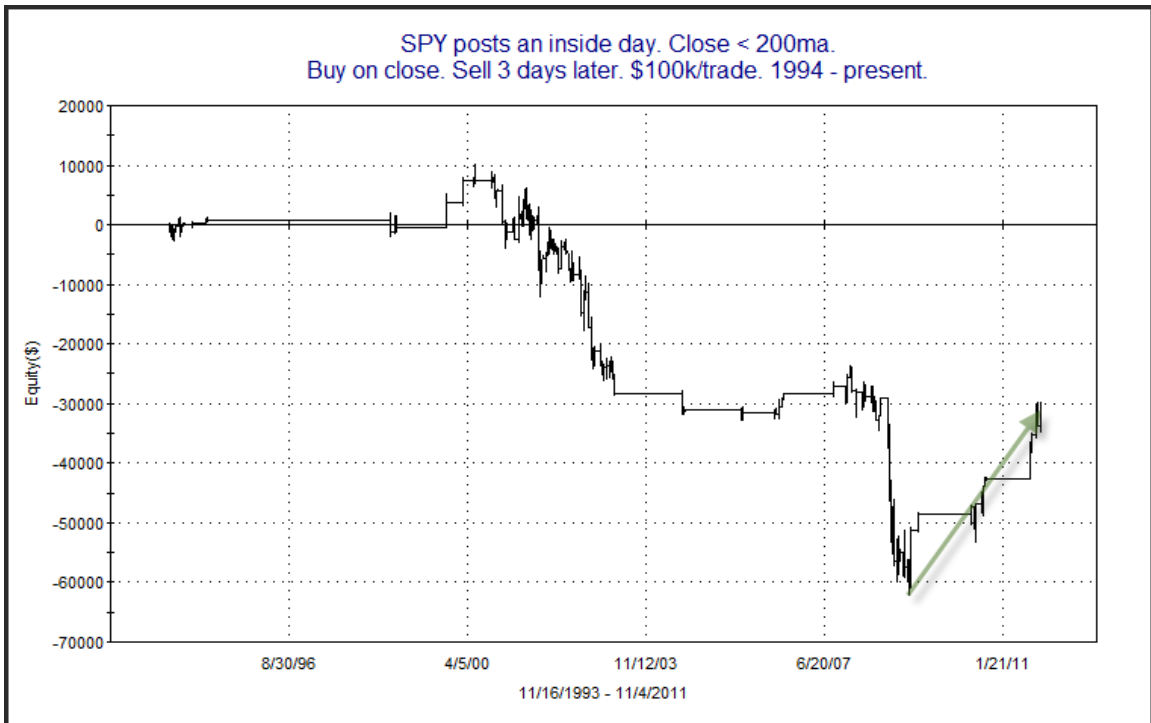
SPY failed to make either a higher high or a lower low than the day before. This is often referred to as an "inside day" because the range was completely inside the previous day's range. In the past I have shown how inside days under the 200ma have often been followed by moves lower. What's interesting is that while that held true for a long time, since the bottom in 2009 it has not been the case. Let's first look at an updated results table based on this setup. The study last appeared in the 8/19/10 letter.

SPY posts an inside day. Close < 200ma. Buy on close. Sell 3 days later. \$100k/trade. 1994 - 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	-26,927.39	101	50	50	49.50	2,283.04	-2,821.59	0.81	0.81	-266.61
4	-8,304.09	113	61	52	53.98	2,113.05	-2,638.47	0.80	0.94	-73.49
3	-30,110.03	119	60	58	50.42	2,093.58	-2,684.91	0.78	0.81	-253.03
2	-28,687.41	133	65	67	48.87	1,460.22	-1,844.80	0.79	0.77	-215.69
1	-21,321.09	139	68	70	48.92	1,074.11	-1,348.01	0.80	0.77	-153.39

As you can see the statistics still appear bearish, with the downside edge basically playing out over the 1st 3 days. But now let's take a look at the profit curve.



Here we see that the last 15 instances have generally been followed by a rise in the market over the next 3 days. Both the 1-day and 2-day profit curves looked very similar to this. I also ran the curve based on date, rather than instance.



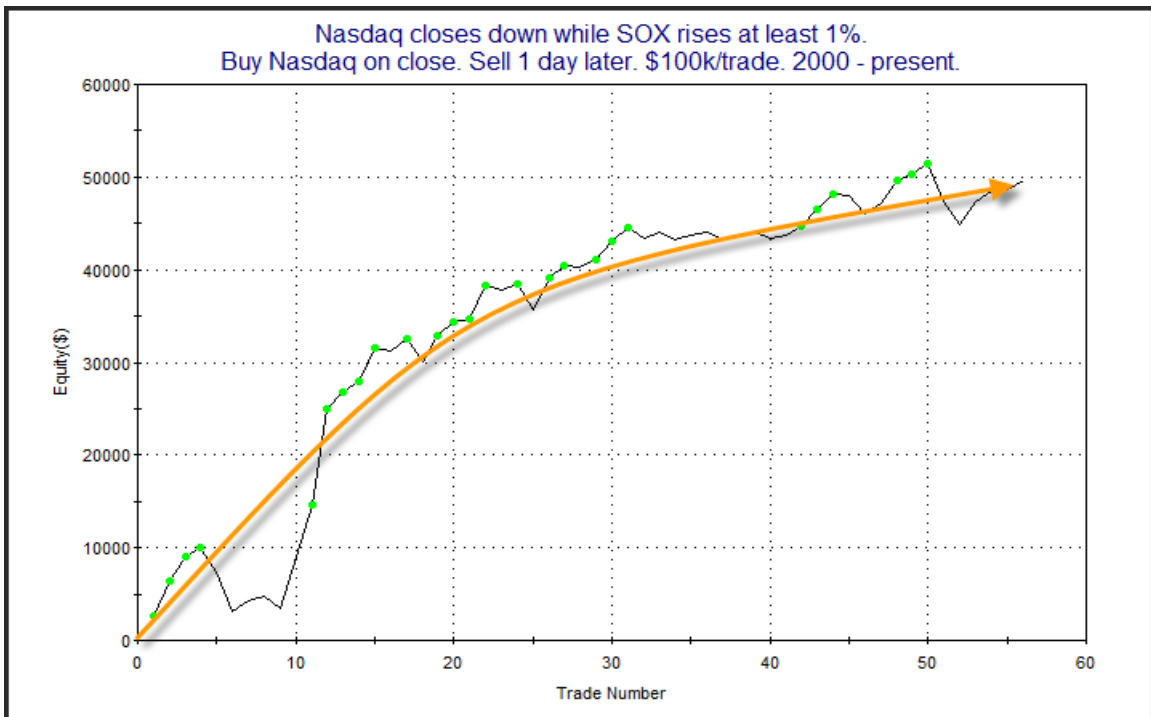
As you can see the last two years the setup has not provided a downside edge. This is long enough for me to set this study aside for the time being.

One potential positive from Friday's action is the strong performance by the semiconductor index (SOX) in the face of the Nasdaq decline. The study below is from the 10/13/09 letter. All results have been updated.

Nasdaq closes down while SOX rises at least 1%.
Buy Nasdaq 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	11,529.44	52	30	22	57.69	3,331.01	-4,018.22	0.83	1.13	221.72
4	34,568.67	55	32	23	58.18	3,147.68	-2,876.40	1.09	1.52	628.52
3	37,927.21	55	34	21	61.82	2,893.56	-2,878.75	1.01	1.63	689.59
2	47,460.93	56	35	21	62.50	2,725.04	-2,281.68	1.19	1.99	847.52
1	49,583.98	56	40	16	71.43	1,904.30	-1,661.76	1.15	2.86	885.43

The stats table seems to suggest a 1-day upside edge for the Nasdaq. The “% Profitable”, “Profit Factor” and “Avg Trade” are all impressive. Below is a profit curve that assumes a 1-day holding period.



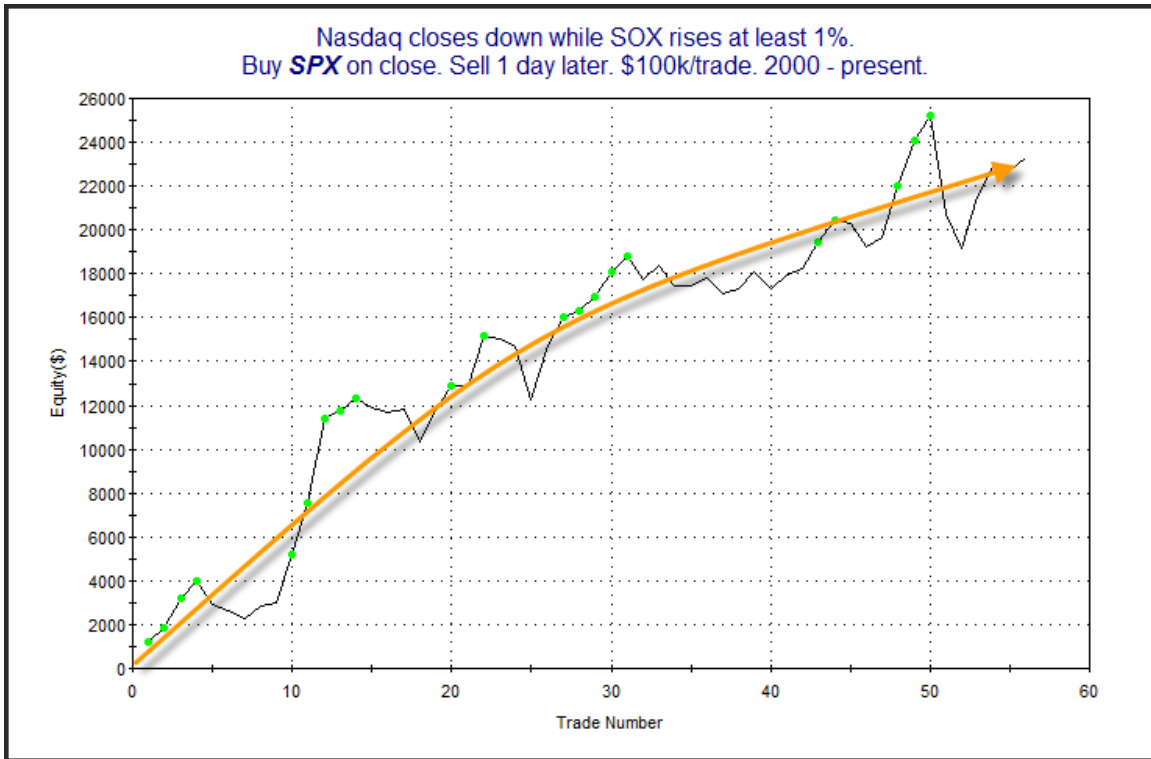
There appears to be some flattening in the curve as some of the biggest winners appeared early on. Still, the slope remains generally up and the study seems to be worth consideration.

Of course the Aggregator anticipates SPX movement not Nasdaq movement, though the two are highly correlated. I decided to see how the SPX has performed when the setup triggered.

TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	\$23,300.51	Profit Factor	2.30
Gross Profit	\$41,215.62	Gross Loss	(\$17,915.11)
Total Number of Trades	56	Percent Profitable	66.07%
Winning Trades	37	Losing Trades	19
Even Trades	0		
Avg. Trade Net Profit	\$416.08	Ratio Avg. Win:Avg. Loss	1.18
Avg. Winning Trade	\$1,113.94	Avg. Losing Trade	(\$942.90)
Largest Winning Trade	\$3,863.25	Largest Losing Trade	(\$4,520.40)

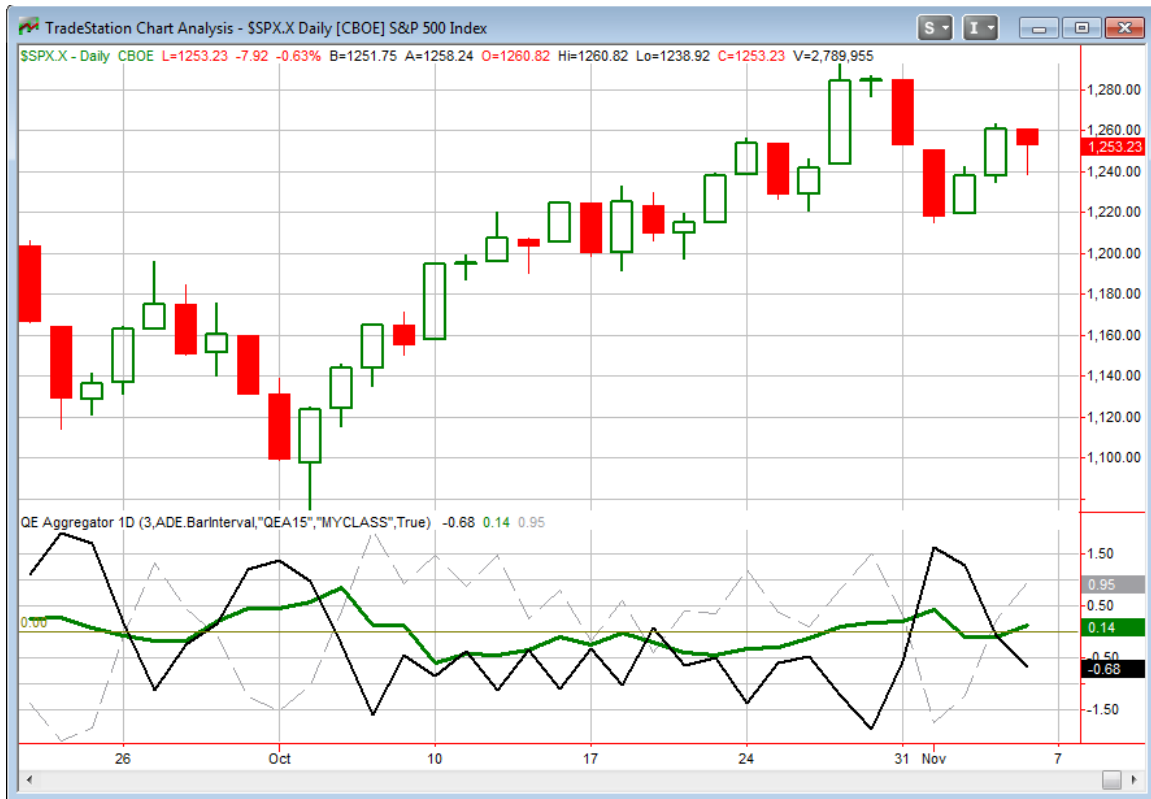
Based on these results it appears the SPX has benefitted as well. The strength of the upside edge isn't quite as strong though. The average instance sees a rise of about 0.4% instead of the 0.9% shown in the Nasdaq results. Traders looking to take advantage of the setup may want to consider trading the Nasdaq rather than the S&P in cases like this.

I also ran the SPX profit curve and have included it below.



The curve here appears a little more consistent than the Nasdaq profit curve.

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



With tonight's bullish SOX study the green Aggregator Line edged back into positive territory. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line is 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 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. This caused the Aggregator System to turn from short back to flat at the close. This was indicated on the systems page as we approached the close.

The short-term Active List only contains the one study tonight, which is very unusual. Activity on Monday and the studies that arise from it will have a strong impact on the Aggregator value. Meanwhile the Differential Pivot will be 1,244.36 on Monday. This is 0.7% below Friday's close. For the Differential line to turn positive and the SPX to be considered short-term oversold it will need to close down at least this much.

The flat Aggregator signal is pretty common when the market is chopping around in the middle of its' range as it has been over the last couple of days. With the current trend and indications I am more comfortable with the long side and will be looking to play longs a

bit more Aggressively than shorts if we get signals in the next few days. For now it is just “wait and see” from an index trading standpoint.

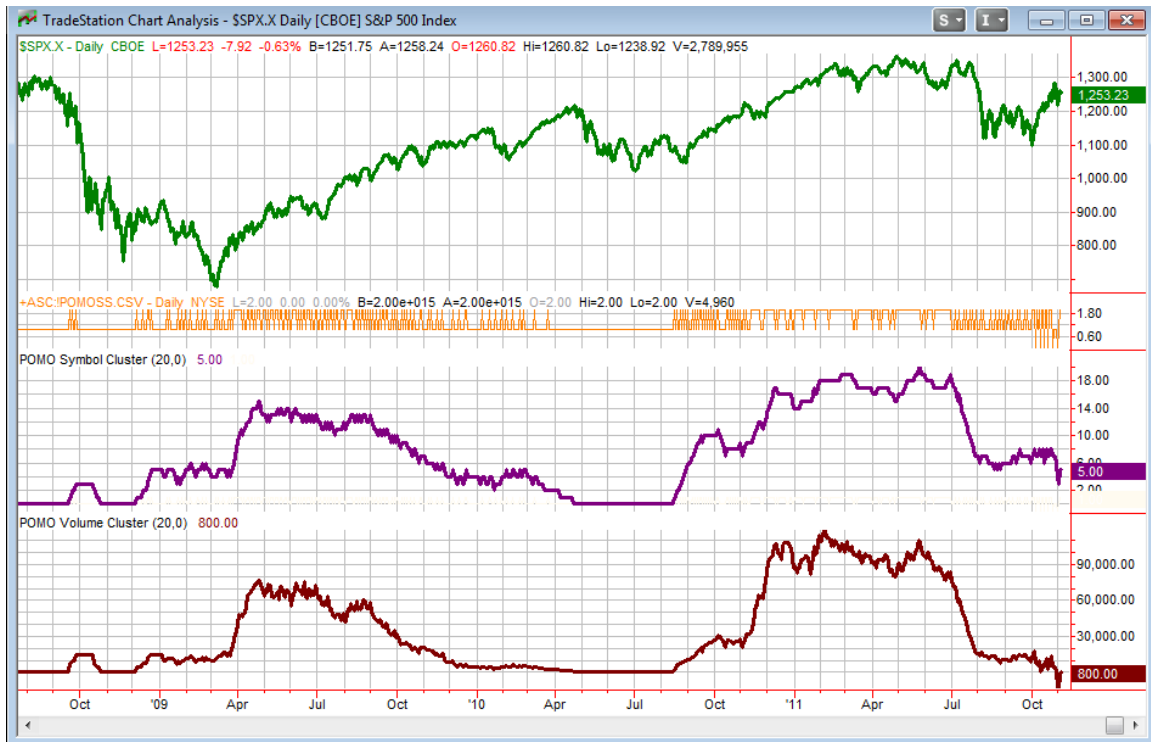
Intermediate-term Outlook (2 weeks – 2 months)– updated 11/7 – bullish

After 4 strong weeks in a row the market suffered its first down week. At this point it just appears to be a pause in the move higher, as most of the intermediate-term evidence remains positive.

I do have some concern with the POMO action, though. 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 net rolling number of days in the last 20 that have been POMO days. In other words, a day the Fed buys on the market will add +1 while a day of selling will count as -1. The bottom pane is the total amount of money infused into (or taken out of) 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>



Again this past week we saw 2 days of buying and 1 day of selling activity from the Fed. But as has been the case recently, selling days when the Fed drains liquidity from the system have been larger than buying days where they inject liquidity. The net result over the last 4 weeks is a very mild positive number. And for the 1st time since Spring 2008 the net number went negative briefly this past week.

There was a strong thrust in the market that began at basically the same time as Operation Twist. At this point it is becoming clear that Operation Twist will not provide a liquidity injection similar to QE1 or QE2. The net numbers may actually be negative. If that turns out to be the case, POMO activity could end up as a strong negative influence on the market. I'll continue to monitor the situation closely.

Overall there still appears to be more favoring the bulls at this point than the bears. I'm currently considering POMO activity as neutral. Bears can look to our SPX/TNX study from last week to support their case. Bullish evidence is based on price and breadth thrusts from a few weeks ago as well as the positive aspects of the IBD Follow Through Day in October. I think this rally has further to go, and we will soon be entering a very bullish time of year for the market. So as I mentioned above, I'm more inclined to favor longs than shorts. I also may look to hold some longs 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

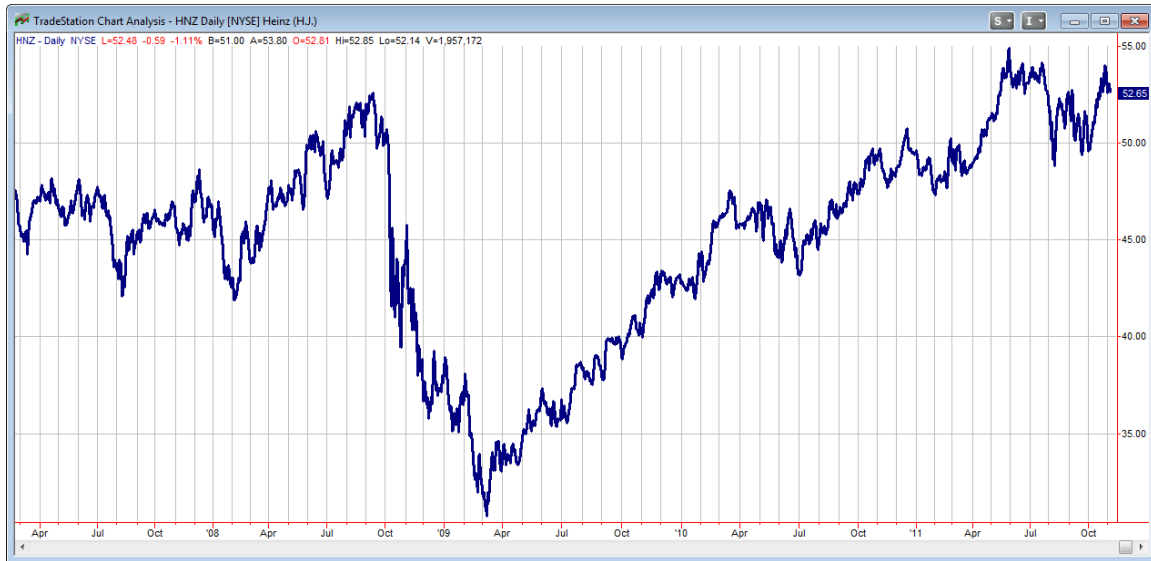
A full listing of system triggers can be found at the [system triggers page](#) each night. I will cherry pick some of my favorite setups from the S&P 100 and ETF lists along with occasional other trade ideas to track below.

HNZ – buy @ \$52.65 limit.. This is based on system 90609 and was shown on the triggers spreadsheet. System 90609 typically has a longer holding period than most of the others. I consider it a trend-continuation system. Most of the other numbered systems are mean-reversion systems. I like taking some shots with 90609 for entries when it appears we may be in the early stages of a multi-month rally. There were 2 stocks among the SP100 that triggered 90609 on Friday. The other was ABT. I chose to highlight HNZ because the long-term chart shows no technical resistance if it can rally above the current consolidation. Below are a couple of charts to illustrate what I see.



A rally above the \$54.50 - \$55.00 area would mark a breakout.

And as you can see in the longer-term chart below, it's all blue skies above this area...



So a 90609 entry here appears to have a very favorable risk/reward.

Current Open Trade Ideas

None

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.