

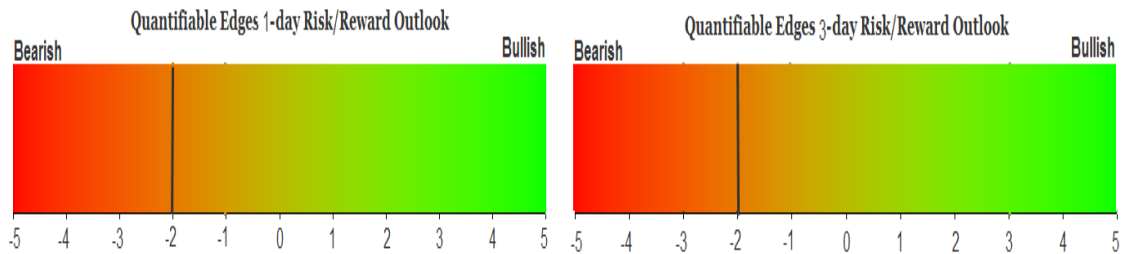
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 8, 2011

Volume 4 Issue 216

Market Overview



Signals Overview

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

Tonight's Research Points

- Monday's extremely low volume casts doubt on the move higher. Such moves have often been followed by pullback when the SPX has been in a similar position.

Short-term Outlook

The Bottom Line

Short-term evidence is now hinting at a pullback and the SPX is moderately overbought. This has the Aggregator System suggesting a downside edge and me looking to take on a small amount of short exposure.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
November 8, 2011	Low volume up day >10ma < 200ma	1-2 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				
<i>November 7, 2011</i>	<i>SOX up 1%. Nasdaq down.</i>	<i>1 day</i>	<i>Bullish</i>	

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

The Evidence

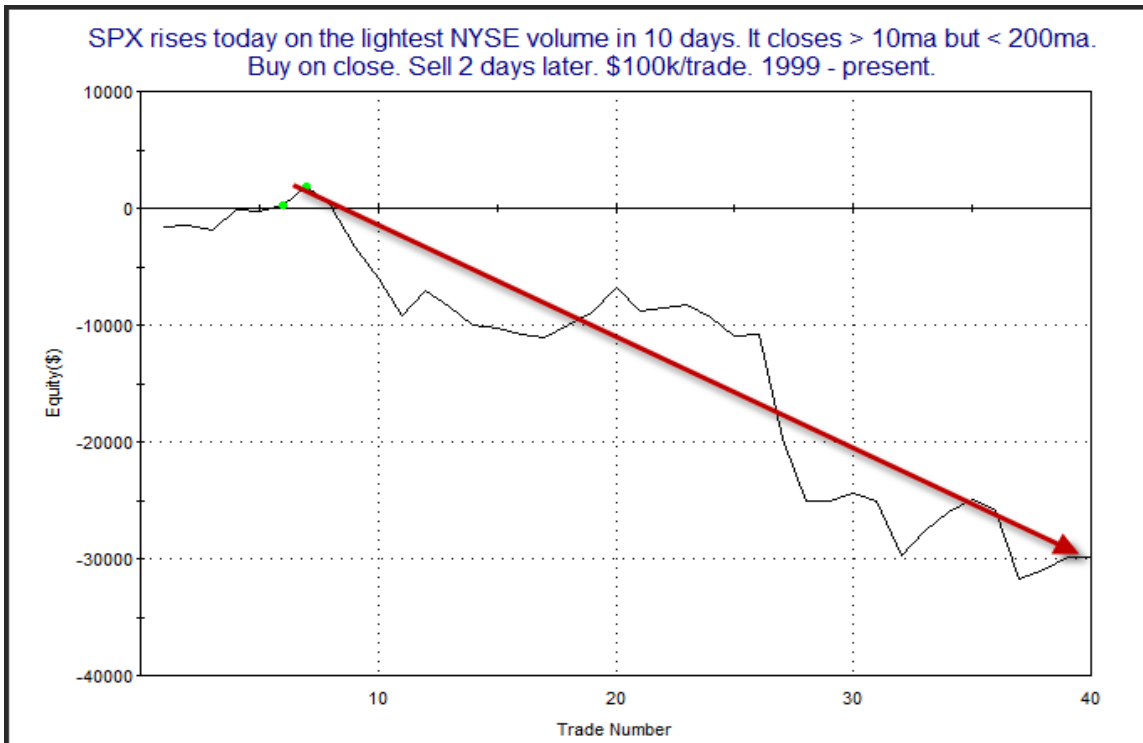
The market spent all morning sliding lower and then all afternoon climbing higher. In the end the indices were mixed. The SPX fared the best with a 0.6% gain. The Nasdaq rose 0.3%, but the Russell 2000 fell 0.2%. Breadth was moderately positive as the NYSE Up Issues % came in at 54% and the Up Volume % was 63%. Total NYSE volume came in very light and at the lowest level in over a month.

Very low volume while the market is rising is often a bearish sign. In the 8/18/11 subscriber letter I looked at this a few different ways. The study below took into account not only the low-volume rise but also the position of the market in relation to its short and long-term moving averages.

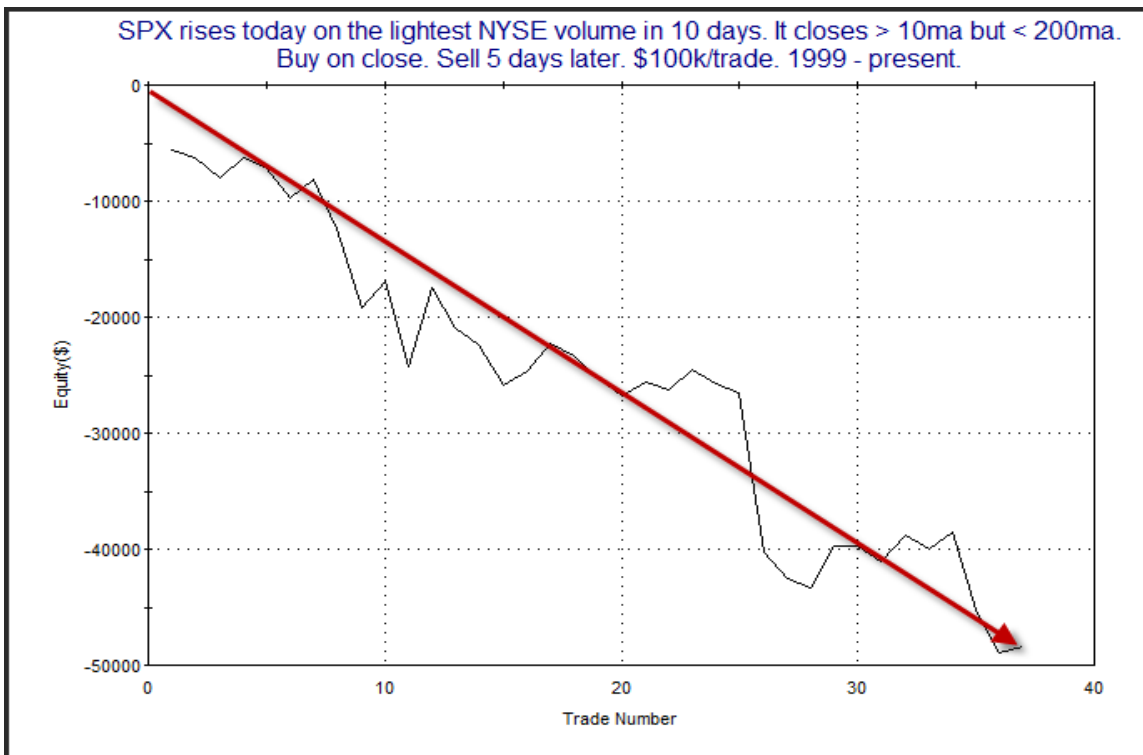
SPX rises today on the lightest NYSE volume in 10 days. It closes > 10ma but < 200ma. Buy on close. Sell X days later. \$100k/trade. 1999 - present.										
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-48,389.33	37	13	24	35.14	2,056.27	-3,130.04	0.66	0.36	-1,307.82
4	-37,913.52	38	16	22	42.11	2,092.78	-3,245.36	0.64	0.47	-997.72
3	-27,815.96	39	15	24	38.46	1,760.14	-2,259.09	0.78	0.49	-713.23
2	-29,864.28	40	18	22	45.00	1,025.23	-2,196.29	0.47	0.38	-746.61
1	-12,082.49	45	21	24	46.67	1,090.00	-1,457.19	0.75	0.65	-268.50

90% of instances closed below the entry price at some point in the next week.

The numbers here appear fairly compelling for the bears. Below are a couple of profit curves. The 1st one uses a 2-day holding period.



The curve here appears a bit choppy, but still generally downsloping. This 2nd curve assumes a 5-day holding period.



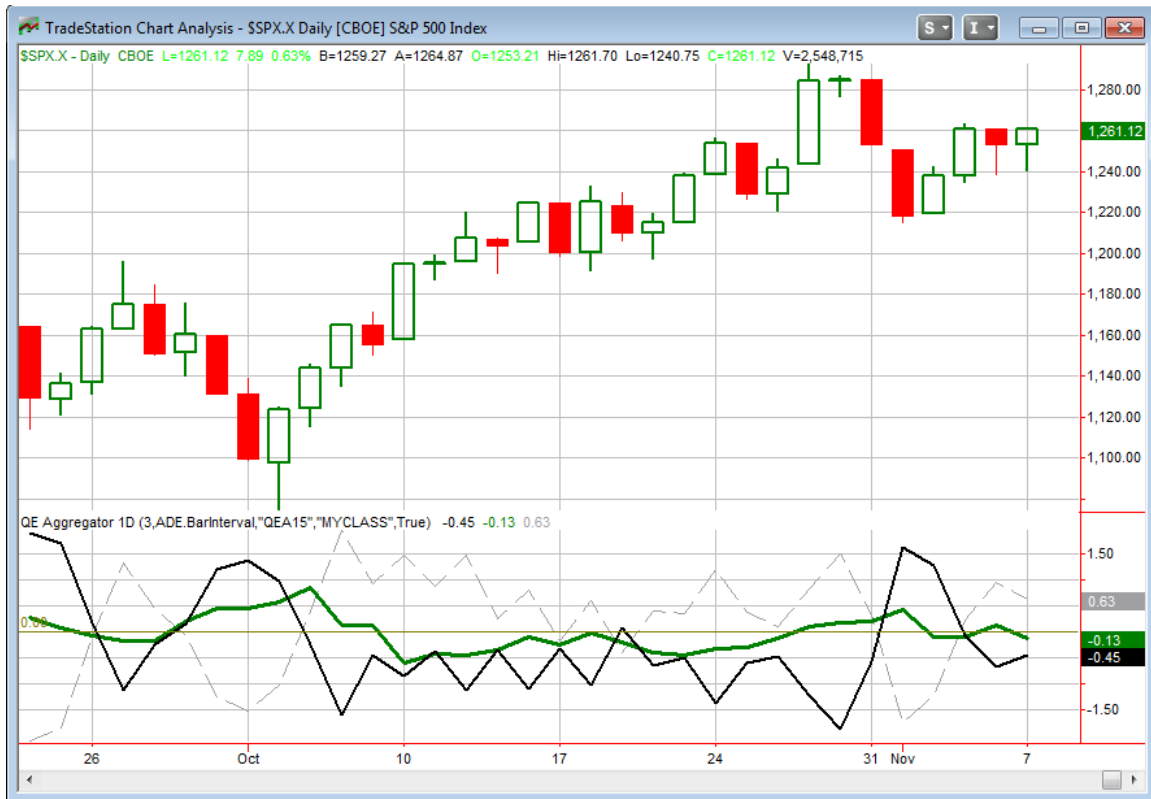
This one is a bit smoother and more consistent. It more strongly suggests a downside edge.

I ran the above tests during the day Monday when it was apparent that volume had a good chance to close at a 10-day low. But it went beyond that. It actually closed at a 20-day low. This was noted in a few Quantifinder studies after the close. So I decided to take the above test and change the requirement from a 10-day volume low to a 20-day volume low.

SPX rises today on the lightest NYSE volume in 20 days. It closes > 10ma but < 200ma. 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	-16,858.22	23	9	14	39.13	2,240.68	-2,644.60	0.85	0.54	-732.97
4	-7,255.00	24	12	12	50.00	1,948.44	-2,553.02	0.76	0.76	-302.29
3	-3,908.39	25	11	14	44.00	1,770.79	-1,670.51	1.06	0.83	-156.34
2	-9,421.32	25	13	12	52.00	973.54	-1,839.77	0.53	0.57	-376.85
1	-5,190.50	28	14	14	50.00	996.53	-1,367.28	0.73	0.73	-185.37

As you can see the numbers were not quite as compelling. Whether this is due to chance or whether a 20-day low in volume is actually less effective than just a 10-day low is tough to tell. Our sample is a little bit small. Overall, it appears to me that the very low volume at least seems to provide a mild downside edge. I will treat it as such and consider it a 2-day downside edge rather than a 5-day downside edge.

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



The low volume study tonight caused the green Aggregator Line to dip back into negative territory. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the black Differential Line is also 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 overbought versus recent expectations. Historically this configuration has provided a bearish edge. Bearish configurations are visible on the chart whenever both lines close below 0. This caused the Aggregator System to turn from flat back to short at the close. This was indicated on the systems page as we approached the close.

The short-term Active List is still light on studies. Activity on Tuesday and the studies that arise from it will therefore have a strong impact on the Aggregator value. Meanwhile the Differential Pivot will be 1,263.95 on Tuesday. This is slightly inverted and about 0.25% above Monday's close. In other words, it will take a rise of about 0.25% to prevent the Differential Line from crossing back above 0. So any flat or down close will mean an end to the current short signal. (Which could also trigger a long signal if compelling bullish studies arise.)

So after being neutral for 1 day the Aggregator is back to a short signal. With my intermediate-term outlook bullish I'm not terribly enthused about short signals at this

time. The inverted Differential Pivot often makes me even less enthused. Still, if I can get a favorable entry I think it may be worth taking a shot with a small position. Essentially I will be looking to short on either a gap-up open or a close above the Differential Pivot where bullish evidence does not flip expectations positive. The inverted pivot means I will be looking to take a quick profit should I get filled and have the trade go my way tomorrow. Details are in the trade ideas section below.

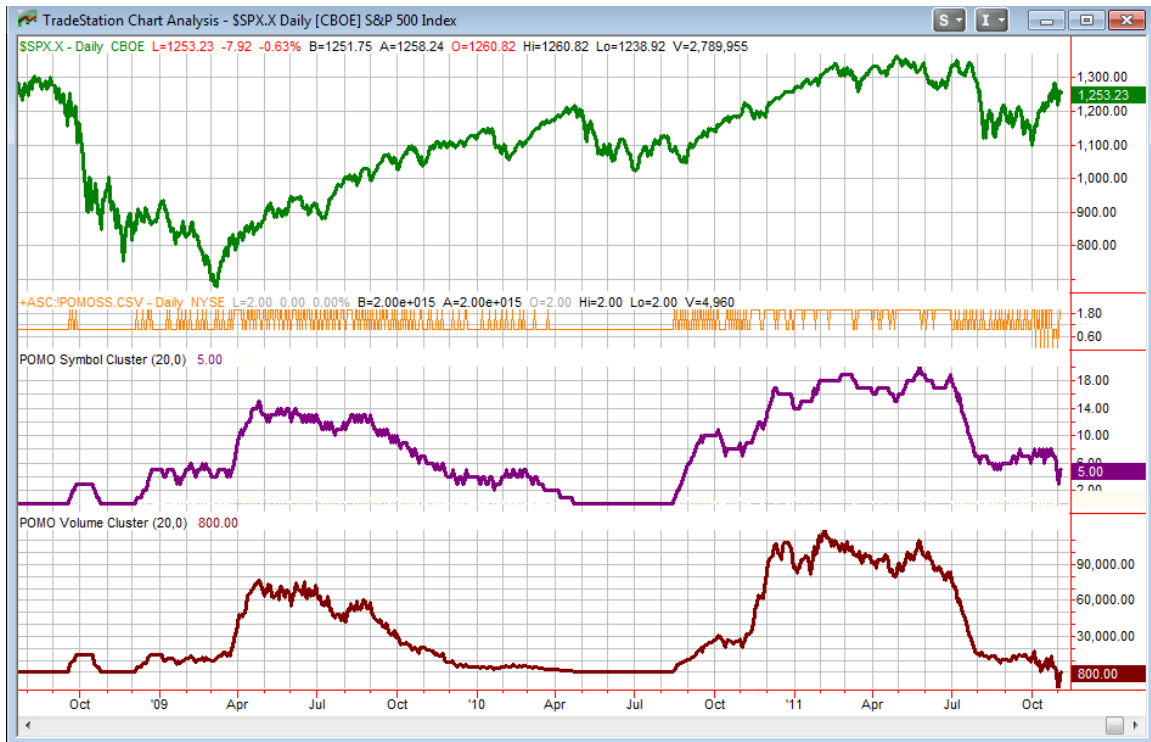
Intermediate-term Outlook (2 weeks – 2 months)– updated 11/7 – bullish

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.

SPY – short ¼ index position @ \$126.50 LIMIT ON OPEN. If not filled on open, then cancel order and look to enter at the close if SPX > Differential Pivot and the systems page still shows a likely “short” signal as we approach the close.** This is based on the short-term outlook above. **If filled at the open I will look to cover the position on any SPX close below the Differential Pivot.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
HNZ	11/7/2011	\$52.65	\$53.46	1.54%		system 90609

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