

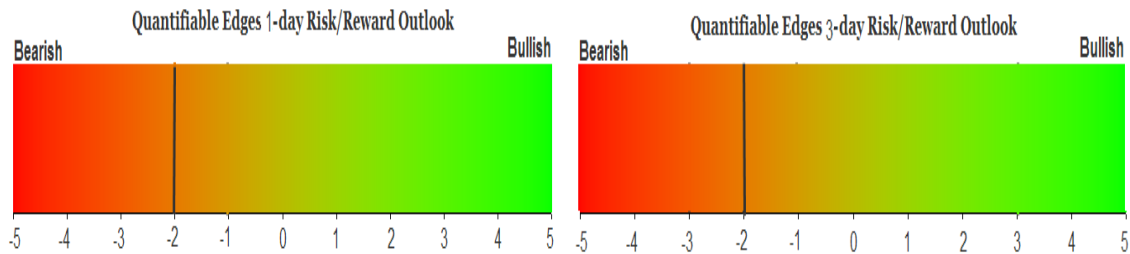
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 15, 2011

Volume 4 Issue 221

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- The low volume and narrow range Monday suggest a downside edge.
- The unfilled gap down with a close below the open following Friday's unfilled gap up with a close above the open also appears to suggest a short-term bearish edge.

## Short-term Outlook

### The Bottom Line

The move lower on Monday showed signs that it was likely just the beginning and there should be more selling in the next few days. The SPX is currently overbought after the strong end to last week. This all suggests a downside edge. I am looking to get short if I can get a favorable entry.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
November 15, 2011	Low vol. Narrow. Close > 10 & < 200.	1-3 days	Bearish	
November 14, 2011	SPY Up 2x. Unfill gap no 10 high.	1-3 days	Bullish	
November 11, 2011	Weak bounce	1-4 days	Bearish	
<b>Active - Long Term</b>				
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	
March 22, 2011	3 Days Up Issues % > 70%	8 months	Bullish	19.00%
<b>Dropped Tonight</b>				
<b>November 14, 2011</b>	<b>SPY Unfill 1% Gap &lt; 200ma</b>	<b>1 day</b>	<b>Bearish</b>	

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

### *The Evidence*

The market opened weakly and never managed to mount any serious rally. The SPX closed down almost 1%, the Nasdaq fell 0.8% and the Russell 2000 slid 1.6%. Breadth was strongly negative as the NYSE Up Issues % was 23% and the Up Volume % was 15%. Total NYSE Volume was extremely light, and it could not be blamed on Veterans Day this time.

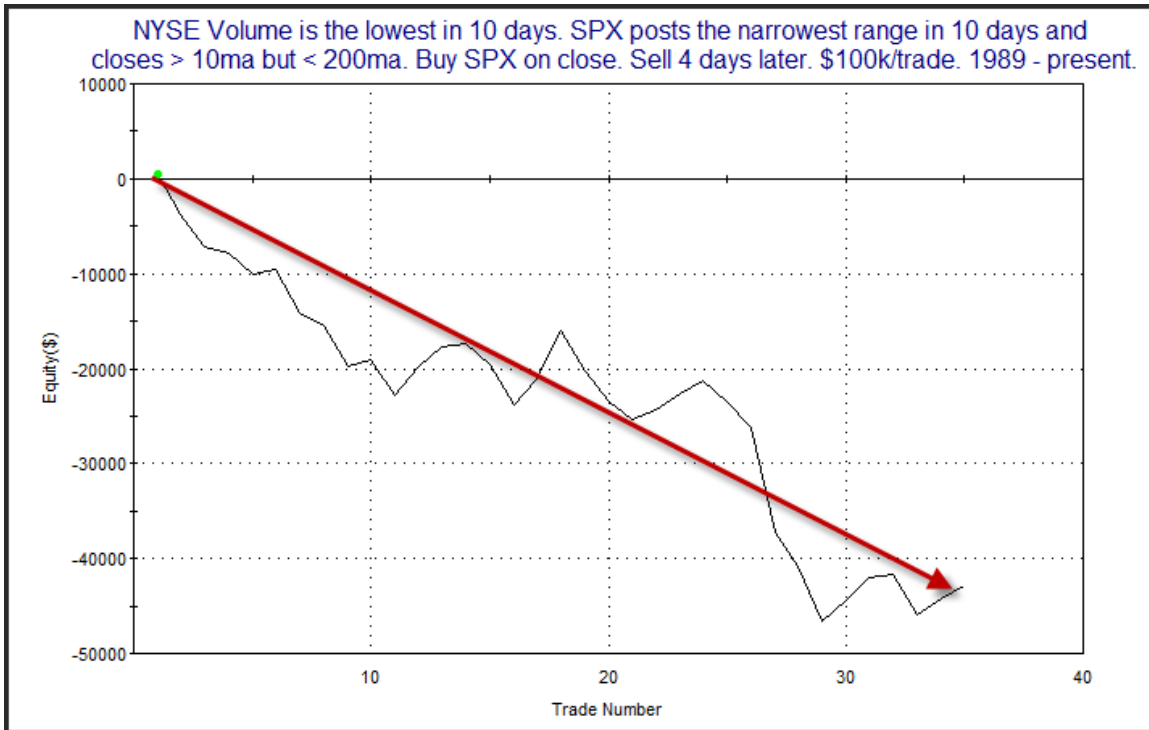
The SPX just missed closing down 1%. Had it managed to do so a few more studies would have triggered. Combined with the extremely low volume and/or the strong move up on Friday these studies would have shown bearish inclinations. The 0.96% drop kept them from triggering, but there were still volume and pattern-based studies that did trigger. And while they perhaps don't paint a picture quite as bearish, the suggestion is still for more selling in the next few days.

The first study below was last seen in the 9/13/10 subscriber letter. It considers the low volume, tight range, and the position of the market.

NYSE Volume is the lowest in 10 days. SPX posts the narrowest range in 10 days and closes > 10ma but < 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1989 - 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	-38,465.63	35	12	23	34.29	2,682.51	-3,071.99	0.87	0.46	-1,099.02
4	-42,921.46	35	16	19	45.71	1,689.04	-3,681.38	0.46	0.39	-1,226.33
3	-32,841.94	36	14	22	38.89	1,820.62	-2,651.39	0.69	0.44	-912.28
2	-31,001.99	36	14	22	38.89	1,368.33	-2,279.94	0.60	0.38	-861.17
1	-20,843.21	37	13	24	35.14	1,142.42	-1,487.28	0.77	0.42	-563.33

**86% of instances closed below the entry price at some point in the next week.**

Results here appear solidly negative. Below is a profit curve that illustrates how the edge has played out over time.



For the 4-day holding period you can see that the downside edge has been choppy, but the inclination has still remained down throughout.

One concern I had tonight when considering this study was that it did not take into consideration the direction of the close. I wondered whether the fact that the SPX closed lower on Monday might have a material impact on the results. So I added that as a filter.

NYSE Volume is lowest in 10 days. SPX posts narrowest range in 10 days and closes > 10ma but < 200ma. Close < yest. Buy SPX on close. Sell X days later. \$100k/trade. 1989 - 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	-5,702.04	19	8	11	42.11	2,574.67	-2,390.86	1.08	0.78	-300.11
4	-11,127.35	19	10	9	52.63	1,562.69	-2,972.70	0.53	0.58	-585.65
3	-14,997.91	19	7	12	36.84	1,668.64	-2,223.20	0.75	0.44	-789.36
2	-8,272.01	19	8	11	42.11	1,363.45	-1,743.60	0.78	0.57	-435.37
1	-5,034.77	19	7	12	36.84	1,053.13	-1,033.89	1.02	0.59	-264.99

The winning % remains similar. It does appear than the lower close may reduce the negative expectation a little bit. Overall I think this study is worthy of consideration. I have decided to use these results to generate expectations rather than the 1<sup>st</sup> test.

Another study that is suggesting bearish consequences looked at the 2-day action in SPY. It was last published in the 10/18/11 letter. I have updated the results below.

SPY has an unfilled gap up that closes higher than the open followed by an unfilled gap down that closes lower than the open. Both gaps are at least 0.25%. Close < 200ma. Buy on close. Sell X days later. \$100k/trade. 2003 - 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	-3,616.71	11	3	8	27.27	2,379.94	-1,344.57	1.77	0.66	-328.79
4	-23,428.50	11	2	9	18.18	2,958.45	-3,260.60	0.91	0.20	-2,129.86
3	-20,310.08	11	4	7	36.36	817.99	-3,368.87	0.24	0.14	-1,846.37
2	-12,601.95	11	3	8	27.27	638.42	-1,814.65	0.35	0.13	-1,145.63
1	-8,685.92	11	3	8	27.27	965.66	-1,447.86	0.67	0.25	-789.63

Potential downside here appears to be sizable. The idea here is that the unfilled gap up with the higher close saw a good number of people chase the market higher. The unfilled gap down immediately after causes many of those same people to be trapped long. Those trapped longs could continue to exert selling pressure over the next few days. I have listed below all of the instances assuming a 4-day holding period.

SPY has an unfilled gap up that closes higher than the open followed by an unfilled gap down that closes lower than the open. Both gaps are at least 0.25%. Close < 200ma. Buy on close. Sell X days later. \$100k/trade. 2003 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
02/19/03	Buy	\$85.18	(0.83%)	\$656.88
02/25/03	Sell	\$84.47		(\$3,472.08)
06/16/06	Buy	\$124.65	(0.15%)	\$842.10
06/22/06	Sell	\$124.46		(\$882.20)
01/15/08	Buy	\$138.17	(5.39%)	\$686.85
01/22/08	Sell	\$130.72		(\$8,798.91)
06/06/08	Buy	\$136.29	(1.35%)	\$886.93
06/12/08	Sell	\$134.45		(\$2,030.41)
06/26/08	Buy	\$128.23	(1.60%)	\$724.47
07/02/08	Sell	\$126.18		(\$1,791.70)
08/29/08	Buy	\$128.79	(3.39%)	\$1,489.92
09/05/08	Sell	\$124.42		(\$5,269.04)
10/21/08	Buy	\$95.86	(12.42%)	\$0.00
10/27/08	Sell	\$83.95		(\$12,682.88)
01/29/09	Buy	\$84.55	(1.44%)	\$1,004.70
02/04/09	Sell	\$83.33		(\$3,829.68)
05/11/09	Buy	\$91.24	(2.77%)	\$646.64
05/15/09	Sell	\$88.71		(\$3,386.64)
09/07/10	Buy	\$109.64	2.81%	\$3,018.72
09/13/10	Sell	\$112.72		\$0.00
10/17/11	Buy	\$120.23	3.11%	\$3,232.59
10/21/11	Sell	\$123.97		(\$855.93)

While the results table appears strongly bearish I do have some concerns here. For one, the number of instances is quite small. Combine that with the fact that the 2 “winners” took place on the last 2 instances and it brings the study into question a bit. I’m often a bit wary of generating estimates from studies with low instances anyway. In this case, while I still believe there remains a bearish suggestion, I am not going to use the study to estimate the bearish potential. Traders could certainly disagree with me here. The net result for the Aggregator is a downside estimate regardless of this decision. Had I calculated the Aggregator with the above results factored in, those estimates would be quite a bit more negative.

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



With tonight’s findings the green Aggregator Line remained negative. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the black Differential Line fell below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations

are bearish and the SPX is overbought versus recent expectations. Historically this combination has provided a downside edge. It can be seen on the chart whenever both lines close below 0. Tonight's movement caused the Aggregator System to turn short at the close. This was shown on the systems page shortly before the bell.

Based on the current studies the Aggregator Line would remain negative on Tuesday. Of course this could change if strong bullish evidence emerges. Meanwhile the Differential Pivot is will be 1,240.87 on Tuesday. This is 0.9% below Monday's close. So for the Differential Line to turn back to positive it will take a decline of at least this much.

In a somewhat unusual move the Aggregator has turned from flat to short despite a sizable selloff on Monday. While I think there is a good chance of further selling, I would prefer to enter at a more favorable price. My intermediate-term bullishness also has me a bit wary. Therefore, rather than use a standard limit order, I will look to enter short on Tuesday on either 1) a gap up or 2) a higher close. Details are in the Trade Ideas section below.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 11/14 – bullish***

Action this week saw the market rise some overall, but the range was completely inside the previous week's range. At this point the market is nearing the October highs and could make an attempt at another leg up.

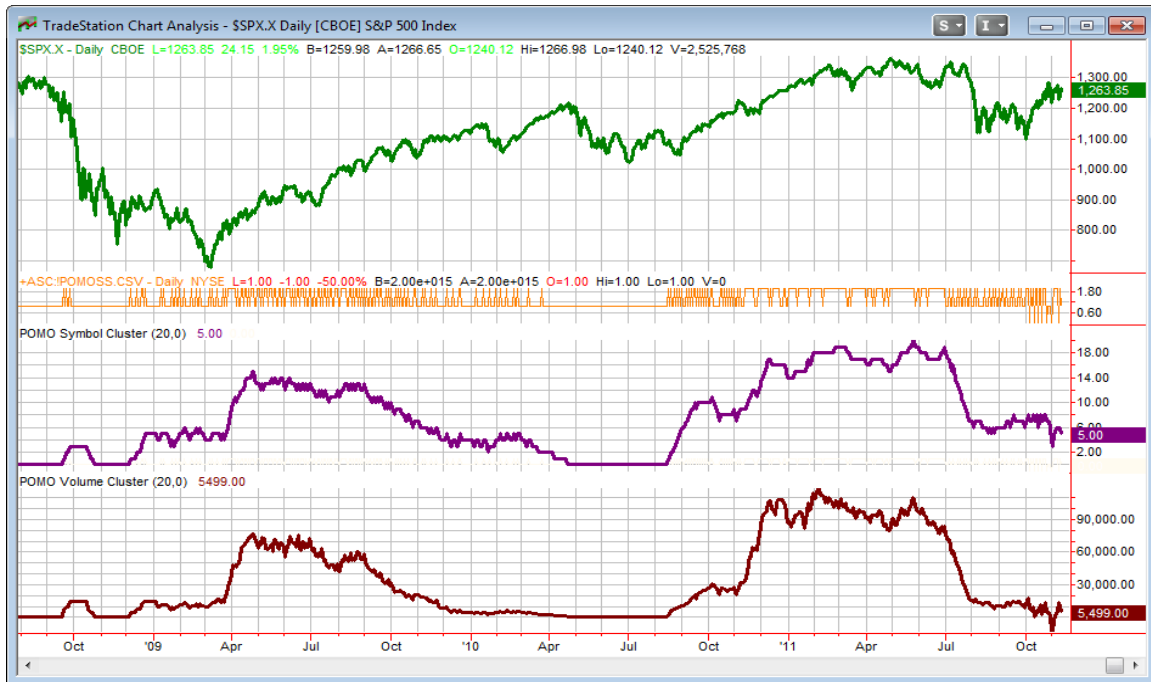
The inside week action failed to give anything new and compelling in the way of intermediate-term studies. The majority of those studies remain bullish and despite the fact that the market is still below its 200ma, the uptrend since early October appears to be in place (though weaker).

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 3<sup>rd</sup> POMO presentation linked below. (Not available for trial users.)

<http://www.quantifiableedges.com/members/pomo.php>



This week we saw 3 days of buying and 1 day of selling activity from the Fed. The buy amounts were stronger than the selling amount as well. So there was net liquidity injected and the POMO Volume Cluster indicator rose nicely. We are still seeing very mild readings.

There was a strong thrust in the market that began at basically the same time as Operation Twist. It is now clear that Operation Twist will not provide a liquidity injection similar to QE1 or QE2. The POMO Volume indicator even dipped briefly into negative territory last week. We'll see if Operation Twist can continue to act as a positive influence or if the market falters without much liquidity being injected into the system.

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 a couple of weeks ago to support their case. Bullish evidence is based on price and breadth thrusts from last month 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 @ \$126.25 LIMIT ON OPEN. If not filled on open, cancel and enter as \$125.50 LIMIT ON CLOSE.** Based on short-term outlook above. If I can get my short entry at a favorable price, then I will take it. Otherwise I will let it pass.*

## **Current Open Trade Ideas**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Price</b>	<b>% Gain/Loss</b>	<b>Stop</b>	<b>Notes</b>
HNZ	11/7/2011	\$52.65	\$53.61	1.82%		system 90609

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