

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 23, 2011

Volume 4 Issue 227

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- Wednesday and Friday of Thanksgiving week have been very strong seasonally – especially when Monday and Tuesday have both closed lower.
- 5 lower SPX closes and a VIX below its 10ma is an unusual situation. It has only happened 5 times, but they have all led to higher prices over the next few days.

## Short-term Outlook

### The Bottom Line

The song remains the same. The market is overdue for a bounce. I am long looking to take advantage of it.

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

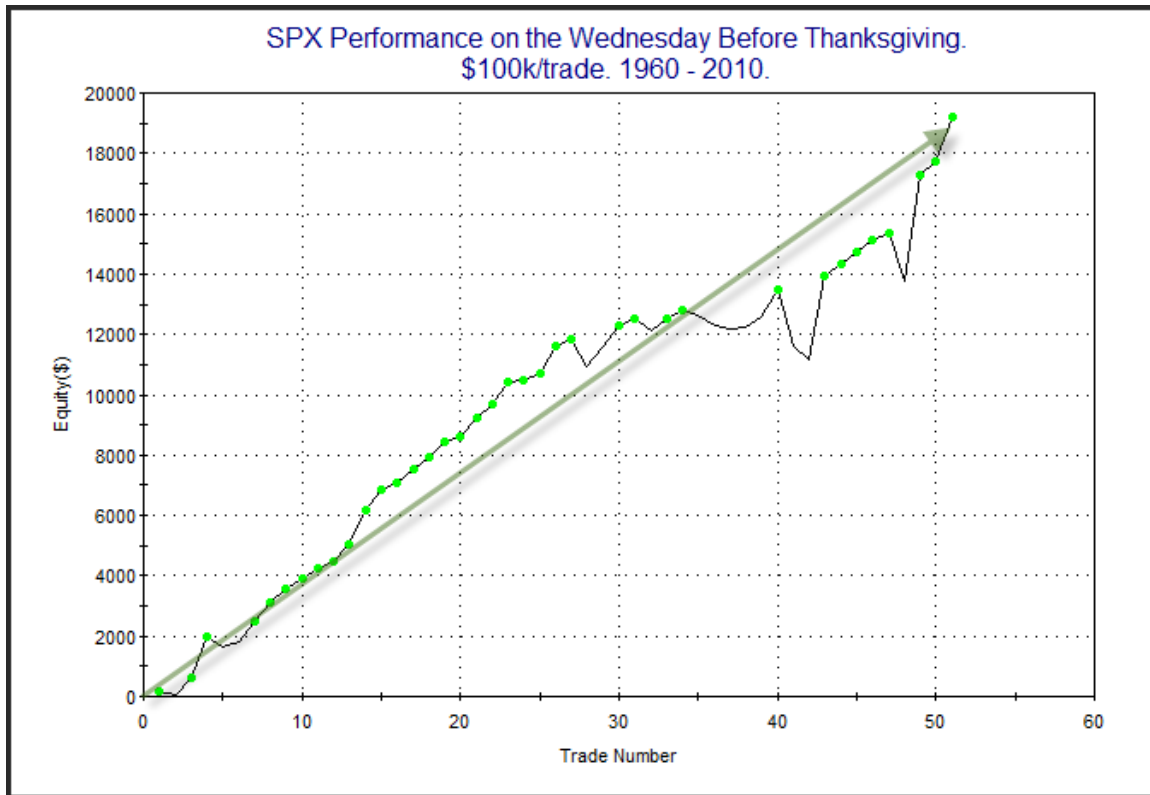
Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
November 23, 2011	Wed-Fri Thanksgiving Bullish	2 days	Bullish	
November 22, 2011	1.75 drops sandwich a lesser one	1-4 days	Bullish	
November 22, 2011	SPX sell off hard, but VIX doesn't spike	1-2 days	Bearish	
<b>Active - Long Term</b>				
November 22, 2011	1.75 drops sandwich a lesser one	1-10 days	Bullish	
November 22, 2011	SPX sell off hard, but VIX doesn't spike	1-10 days	Bearish	
November 18, 2011	Triangle breakdown	int term	Bullish	
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	

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

### *The Evidence*

Despite being overdue for a bounce this market can't seem to muster one. Indices were mostly lower again Tuesday. The SPX closed down 0.4%, the Nasdaq lost 0.1%, and the Russell 2000 dropped 0.8%. Breadth was squarely negative as the NYSE Up Issues % came in at 38% and the Up Volume % was 27%. Total NYSE volume declined – perhaps partially because we are approaching the holiday. I expect Wednesday's volume to be very light, and Friday even more so.

I discussed in Sunday night's letter that Wednesday and Friday surrounding Thanksgiving have traditionally been bullish. Below is the Wednesday profit curve from that letter.



As you can see the upside inclination has been very strong over the years. Friday was also shown to be strong. Below is a copy of the study that looked to buy Tuesday's close and sell Friday's close.

Buy SPX on close the Tuesday before Thanksgiving and sell the close on Friday.  
\$100k/trade. 1960 - 2010.

TradeStation Performance Summary <span style="float: right;">Collapse ^</span>			
All Trades			
Total Net Profit	\$34,906.00	Profit Factor	7.05
Gross Profit	\$40,675.94	Gross Loss	(\$5,769.94)
Total Number of Trades	51	Percent Profitable	84.31%
Winning Trades	43	Losing Trades	8
Even Trades	0		
Avg. Trade Net Profit	\$684.43	Ratio Avg. Win:Avg. Loss	1.31
Avg. Winning Trade	\$945.95	Avg. Losing Trade	(\$721.24)
Largest Winning Trade	\$4,506.60	Largest Losing Trade	(\$2,450.25)

Again we see strong numbers. In the 11/24/10 subscriber letter I looked at the Tues-Fri hold when Monday and Tuesday of Thanksgiving week both closed down. I have updated that study below.

SPX closes down Monday and Tuesday before Thanksgiving.  
Buy Tuesday's close. Sell Friday's close. \$100k/trade. 1960 - present.

TradeStation Performance Summary <span style="float: right;">Collapse ^</span>			
All Trades			
Total Net Profit	\$8,059.09	Profit Factor	13.13
Gross Profit	\$8,723.71	Gross Loss	(\$664.62)
Total Number of Trades	9	Percent Profitable	88.89%
Winning Trades	8	Losing Trades	1
Even Trades	0		
Avg. Trade Net Profit	\$895.45	Ratio Avg. Win:Avg. Loss	1.64
Avg. Winning Trade	\$1,090.46	Avg. Losing Trade	(\$664.62)
Largest Winning Trade	\$1,974.02	Largest Losing Trade	(\$664.62)

Instances are low but the stats are heavily lopsided towards the short-term bullish case. All the dates are listed below.

SPX closes down Monday and Tuesday before Thanksgiving.  
Buy Tuesday's close. Sell Friday's close. \$100k/trade. 1960 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
11/24/64	Buy	\$85.73	(0.66%)	\$0.00
11/27/64	Sell	\$85.16		(\$664.62)
11/22/66	Buy	\$79.67	1.48%	\$1,480.90
11/25/66	Sell	\$80.85		\$0.00
11/25/69	Buy	\$92.94	0.94%	\$935.25
11/28/69	Sell	\$93.81		\$0.00
11/23/71	Buy	\$90.16	1.97%	\$1,974.02
11/26/71	Sell	\$91.94		\$0.00
11/20/73	Buy	\$98.66	0.79%	\$1,114.30
11/23/73	Sell	\$99.44		\$0.00
11/23/82	Buy	\$132.92	1.47%	\$2,037.92
11/26/82	Sell	\$134.88		(\$586.56)
11/22/94	Buy	\$450.08	0.49%	\$619.38
11/25/94	Sell	\$452.29		(\$1,309.80)
11/23/99	Buy	\$1,404.64	0.85%	\$1,462.60
11/26/99	Sell	\$1,416.62		(\$388.37)
11/23/10	Buy	\$1,180.73	0.73%	\$1,502.76
11/26/10	Sell	\$1,189.40		\$0.00

Going back to 1964 we have now had 8 instances in row move higher over the next 2 days.

I noted last night that while the SPX was stretched below its' lower Bollinger Band, the VIX was not even 5% above its 10ma. This setup suggested bearish inclinations over a 2-day period (and then again after about 7-10 days). The conditions that triggered the setup were present again today. I checked to see if there were other instances where the conditions were present for 2 days in a row. There were only two. While you can't draw any conclusions from 2 instances I found it interesting that they both moved higher over the next several days rather than lower.

But today the VIX actually closed below its 10ma. I decided to look at other times the SPX closed lower for 5 days in a row and the VIX closed below its 10ma. Results are below.

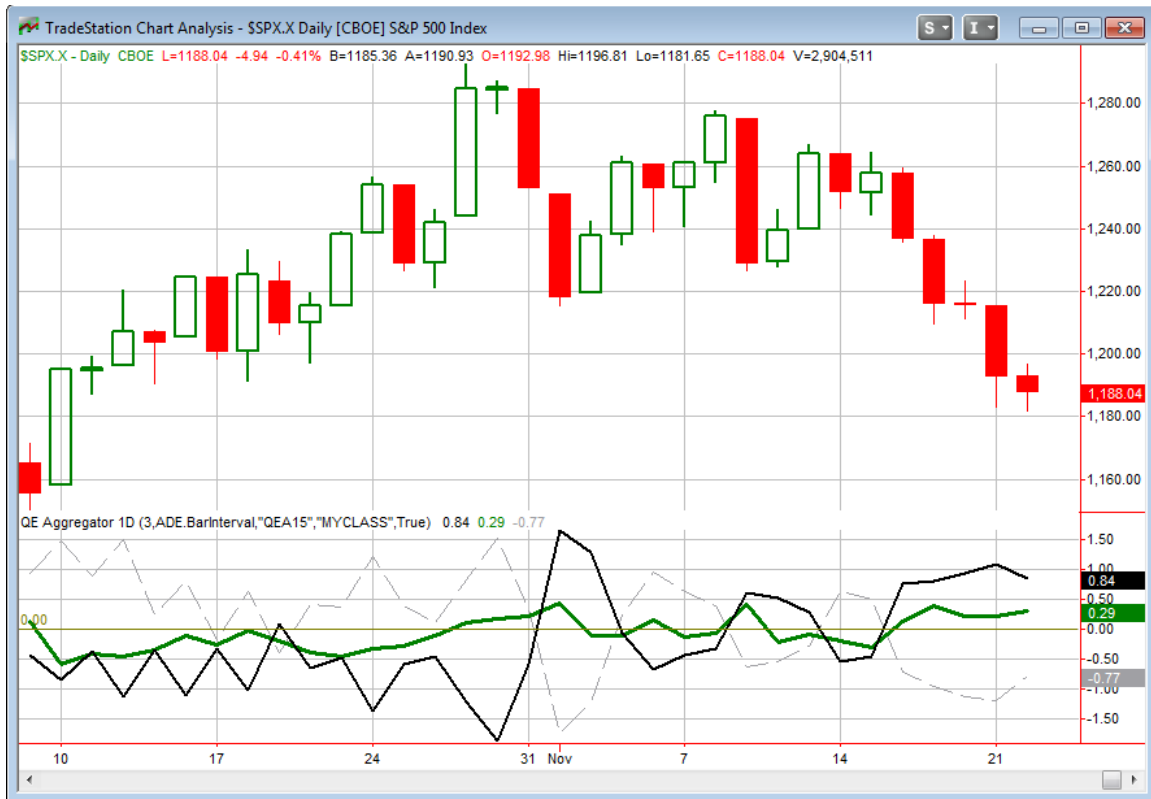
SPX closes lower for the 5th day in a row. VIX closes < 10ma. Buy SPX on close. Sell X days later. \$100k/trade. 1990 - present.										
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	10,656.19	5	4	1	80.00	2,896.25	-928.80	3.12	12.47	2,131.24
4	11,339.38	5	5	0	100.00	2,267.88	0.00	100.00	100.00	2,267.88
3	8,070.35	5	5	0	100.00	1,614.07	0.00	100.00	100.00	1,614.07
2	2,303.65	5	4	1	80.00	745.11	-676.80	1.10	4.40	460.73
1	2,468.11	5	4	1	80.00	830.23	-852.80	0.97	3.89	493.62

Instances are low but all point in the same direction. So I decided to look at the individual trades.

SPX closes lower for the 5th day in a row. VIX closes < 10ma. Buy SPX on close. Sell 4 days later. \$100k/trade. 1990 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
03/12/91	Buy	\$370.03	0.56%	\$2,227.50
03/18/91	Sell	\$372.11		(\$156.60)
10/22/93	Buy	\$463.27	0.96%	\$1,180.35
10/28/93	Sell	\$467.73		(\$262.30)
03/01/99	Buy	\$1,236.16	3.18%	\$3,161.60
03/05/99	Sell	\$1,275.47		(\$1,610.40)
05/11/01	Buy	\$1,245.65	3.44%	\$4,066.40
05/17/01	Sell	\$1,288.49		(\$370.40)
03/24/04	Buy	\$1,091.32	3.27%	\$3,301.48
03/30/04	Sell	\$1,127.00		\$0.00

Too few instances to generate meaningful statistics from, but the fact that all 5 rose over the next few days suggests the market is capable of rallying despite the lackadaisical VIX. If we get a VIX spike here, it would suggest to me that people are throwing in the towel and the down move is exhausted. So while I have been saving some capital to put to work in case of a VIX or CBI spike, I don't believe it is a necessary condition for a bounce.

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



With tonight's studies the green Aggregator Line remained squarely in 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 also well above 0. A positive Differential reading means the SPX has underperformed expectations over the last few days. So net expectations are bullish and the SPX is oversold versus recent expectations. While it hasn't played out the last few days, historically this combination has provided an upside edge. The bullish configuration can be seen on the chart whenever both lines close above 0. Tonight's movement caused the Aggregator System to remain long at the close. This was posted to the systems page before the bell.

The short-term active studies are currently set up to remain net positive on Wednesday. Of course this could change if compelling bearish evidence emerges. The Differential Pivot will be 1,223.91 on Wednesday. This is 3% above Tuesday's close. So the SPX will need to close up at least this much in order for the Differential Line to drop back below 0. This is highly unlikely to happen in 1 day. It still appears it will take a multi-day rally or consolidation to relieve the oversold condition.

Evidence continues to favor the bullish case. Nothing really has changed for me since last night. I am content with my current positions and not looking to increase at this point. While my SPY positions have struggled the XIV trade idea is holding up very well

and is even quite profitable. Should we get a bounce before a VIX spike, then this position could do extremely well.

### **Quick note on after-hours drop in the futures**

As I am readying to send this the futures are down over 1%. Unless they turn around it will put Wednesday off to a difficult start. I checked to find other instances where after closing lower for at least 5 days in a row, the SPY gapped down over 1% at the open. I noted only 4 occurrences: 9/24/02, 1/4/08, 1/23/08, and 10/10/08. The 1/4/08 instance was followed by more selling over the next few days. The other 3 instances saw quick, sharp bounces. Not an edge – just an observation.

### ***Intermediate-term Outlook (2 weeks – 2 months)– updated 11/21 – bullish***

The pullback from the October high hit new lows this past week. A triangle breakdown has been getting lots of attention but it is of little concern to me.

The last couple of days I've discussed the propensity of triangle breaks to reverse. As the triangle study available on the downloads page was designed the downside target for a “successful” triangle breakdown would be 1,153.29. But about 70% of the triangle breaks failed. This suggests we have a much better chance of seeing 1,266.99 (which would mark a “failure”) before we see 1,153.29. That's supportive for the bullish case.

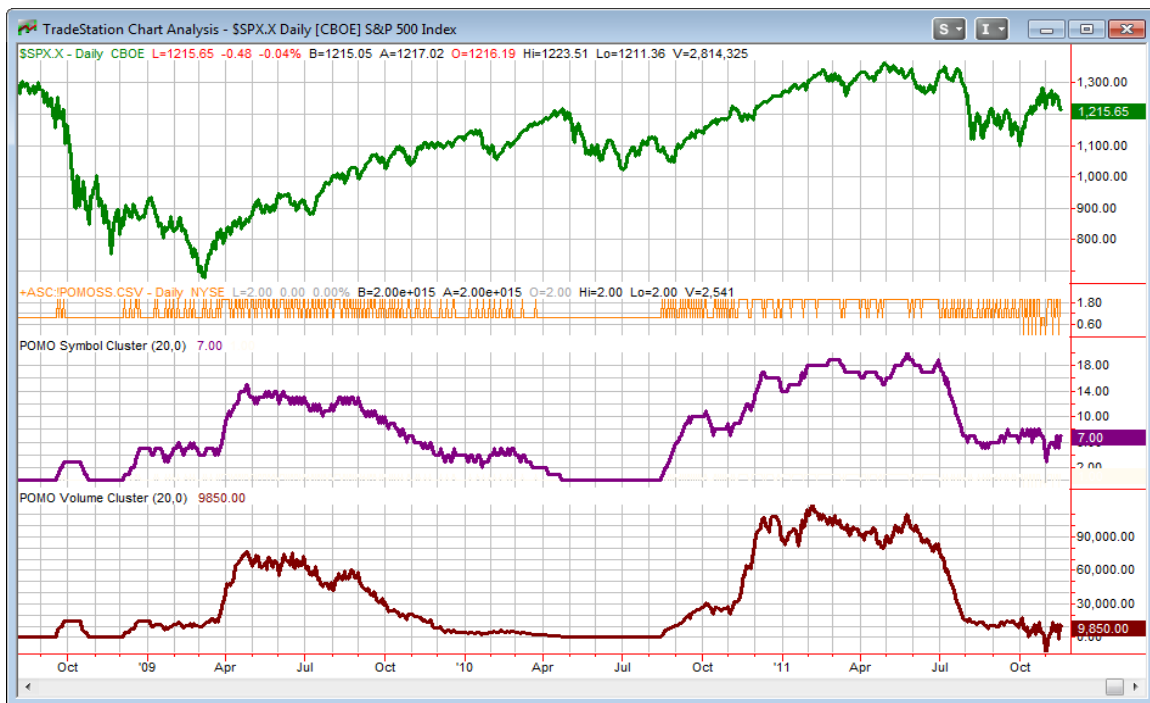
Subscribers can download a .zip file from the [Downloads page](#) on the website with information containing triangles. The .zip file contains a 7-page research write-up, some performance reports of a triangle trading strategy, and a text file with Tradestation code that Tradestation and non-Tradestation subscribers can use for their own testing.

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 4 days of buying and 1 day of selling activity from the Fed. Overall this resulted in a net equity injection. 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 a few weeks ago. 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 few 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, and now the triangle breakdown. I still think this rally has further to go, and we are now entering a very bullish time of year for the market. So I'm

still 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.*

***No new trade ideas tonight.*** For those who may be looking for more long exposure, there are several triggers listed tonight on the systems triggers spreadsheet. Both individual stocks and ETFs are showing an ample number of setups.

### **Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	11/17/2011	\$123.85	\$119.19	-3.76%		Aggregator
XIV(1/2)	11/17/2011	\$5.21	\$5.21	0.00%		VIX-based ETF systems
SPY(1/4)	11/18/2011	\$122.11	\$119.19	-2.39%		Aggregator
XIV(1/2)	11/21/2011	\$4.91	\$5.21	6.11%		VIX-based ETF systems
SPY(1/4)	11/21/2011	\$119.66	\$119.19	-0.39%		Aggregator

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