

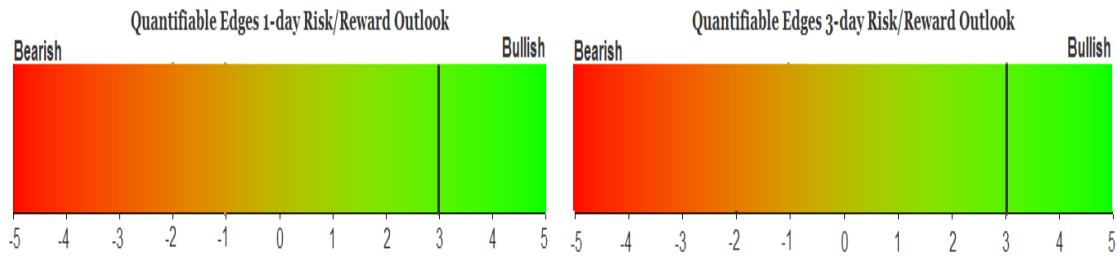
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 25, 2011

Volume 4 Issue 228

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- More strong selling failed to generate much fear as measured by the VIX. This suggests downside risk.
- The already oversold market accelerated to the downside on Wednesday, suggesting an upside edge.
- Friday is seasonally bullish.

## Short-term Outlook

### The Bottom Line

The market is now severely oversold. The accelerated downside movement is suggestive of an upside edge. But the lack of fear could be troublesome. Net expectations are positive and with the strong oversold condition the edge appears to be to the upside. I am long and looking for a bounce.

*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 25, 2011	Oversold and accelerating south	1-2 days	Bullish	
November 25, 2011	SPX sell off hard, but VIX doesn't spike	1-2 days	<b>Bearish</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	
<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	<b>Bearish</b>	
November 18, 2011	Triangle breakdown	int term	Bullish	
October 30, 2011	SPX & bond yields hit 50-day highs	1-50 days	<b>Bearish</b>	
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***

Wednesday saw the market sell off for the 6<sup>th</sup> day in a row – and it was the worst selling of the 6. It was also the worst selloff on the Wednesday before Thanksgiving since the inception of the S&P 500. The SPX declined 2.2%, the Nasdaq dropped 2.4%, and the Russell 2000 lost 3.2%. Breadth was extremely negative as the NYSE Up Issues % came in at 13% and the Up Volume % was 4%. Total NYSE volume ticked up as traders rushed to get flat ahead of the holiday.

A decent number of studies showed up in the Quantifinder. Several of them were related and suggested the market is oversold and primed for a bounce. In fact, much of the same conditions that were present coming in to Monday are present again, and several of those studies are repeating.

One with negative implications examined the strong oversold condition and the lackadaisical VIX. It appeared just 2 days ago in the 11/22/11 letter. I have updated the table below.

SPX closes under lower Bollinger Band. VIX closes < 5% above 10ma. Buy SPX 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	-27,756.96	13	3	10	23.08	3,980.17	-3,969.75	1.00	0.30	-2,135.15
9	-17,483.61	13	3	10	23.08	4,289.90	-3,035.33	1.41	0.42	-1,344.89
8	-18,035.78	13	5	8	38.46	2,405.37	-3,757.83	0.64	0.40	-1,387.37
7	-11,937.07	13	5	8	38.46	2,799.08	-3,241.56	0.86	0.54	-918.24
6	-11,355.32	13	4	9	30.77	2,527.03	-2,384.83	1.06	0.47	-873.49
5	-11,337.35	13	4	9	30.77	2,485.77	-2,364.49	1.05	0.47	-872.10
4	-8,856.23	13	5	8	38.46	1,663.96	-2,147.00	0.78	0.48	-681.25
3	-6,991.57	14	7	7	50.00	954.52	-1,953.31	0.49	0.49	-499.40
2	-14,033.28	16	5	11	31.25	770.48	-1,625.97	0.47	0.22	-877.08
1	-7,288.58	19	6	13	31.58	970.08	-1,008.39	0.96	0.44	-383.61

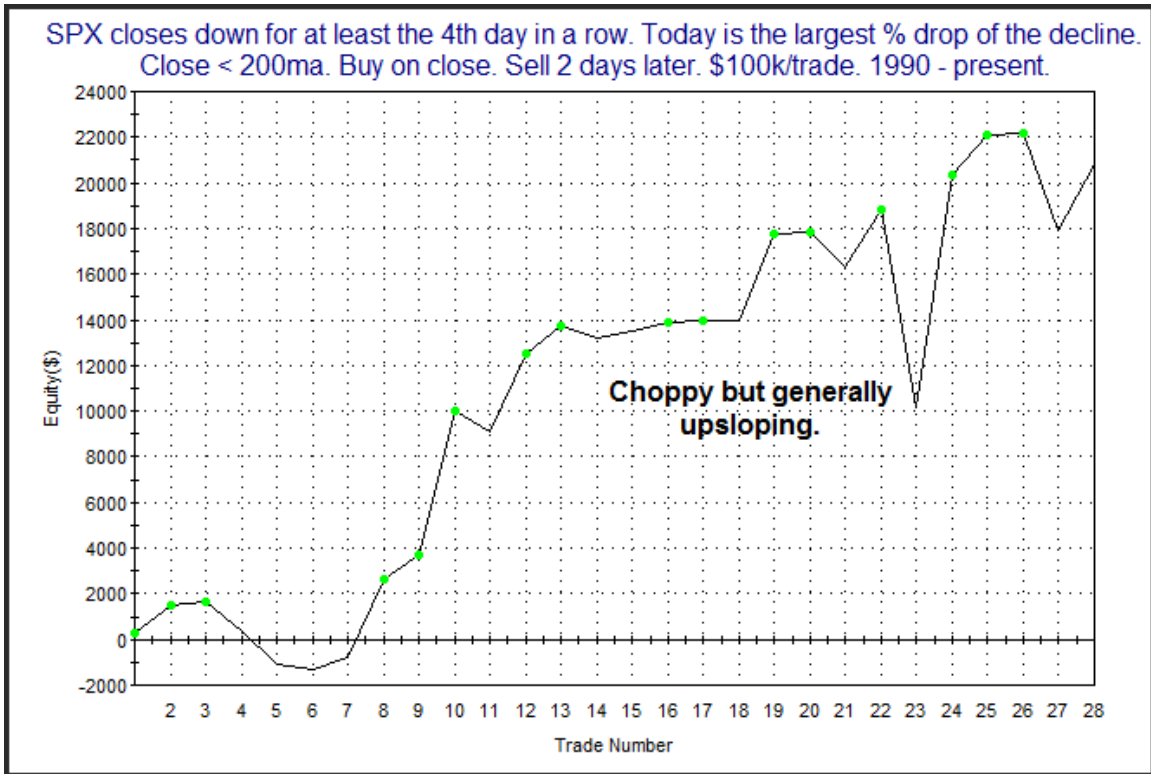
It's extremely unusual to see this study continue to trigger the way it has. The only other times it has done so were 4/1/97 and 6/7/11. If you would like to see a full list of instances you may refer to the 11/22/11 subscriber letter from a few days ago.

But while the VIX continues to suggest caution, price and breadth measures are incredibly overdone. The study below is from the 9/5/08 blog. It looks at what happens when an already extended selloff experiences an intense 1-day drop.

SPX closes down for at least the 4th day in a row. Today is the largest % drop of the decline. Close < 200ma. Buy 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	19,639.29	27	16	11	59.26	2,769.22	-2,242.56	1.23	1.80	727.38
4	76.35	27	16	11	59.26	1,790.80	-2,597.85	0.69	1.00	2.83
3	56.20	27	16	11	59.26	1,992.09	-2,892.47	0.69	1.00	2.08
2	20,842.97	28	19	9	67.86	2,082.57	-2,080.66	1.00	2.11	744.39
1	12,156.29	29	18	11	62.07	1,120.60	-728.59	1.54	2.52	419.18

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

The consistency of some bounce occurring is strong and the 1<sup>st</sup> 2 days look promising. Below is an equity curve.



While it is not the smoothest looking equity curve it starts at the lower left and ends at the upper right and generally works its way higher. So there seems to be some potential. Of course the current setup is not down just 4 days, but 6. If I required the pullback to be at least 6 days with the last being the worst then there have only been 2 instances over the period. They triggered on 10/9/08 (1 day ahead of the big reversal in October 2008) and 8/2/11 (which bounced weakly the next day and then suffered strong selling in the days that followed).

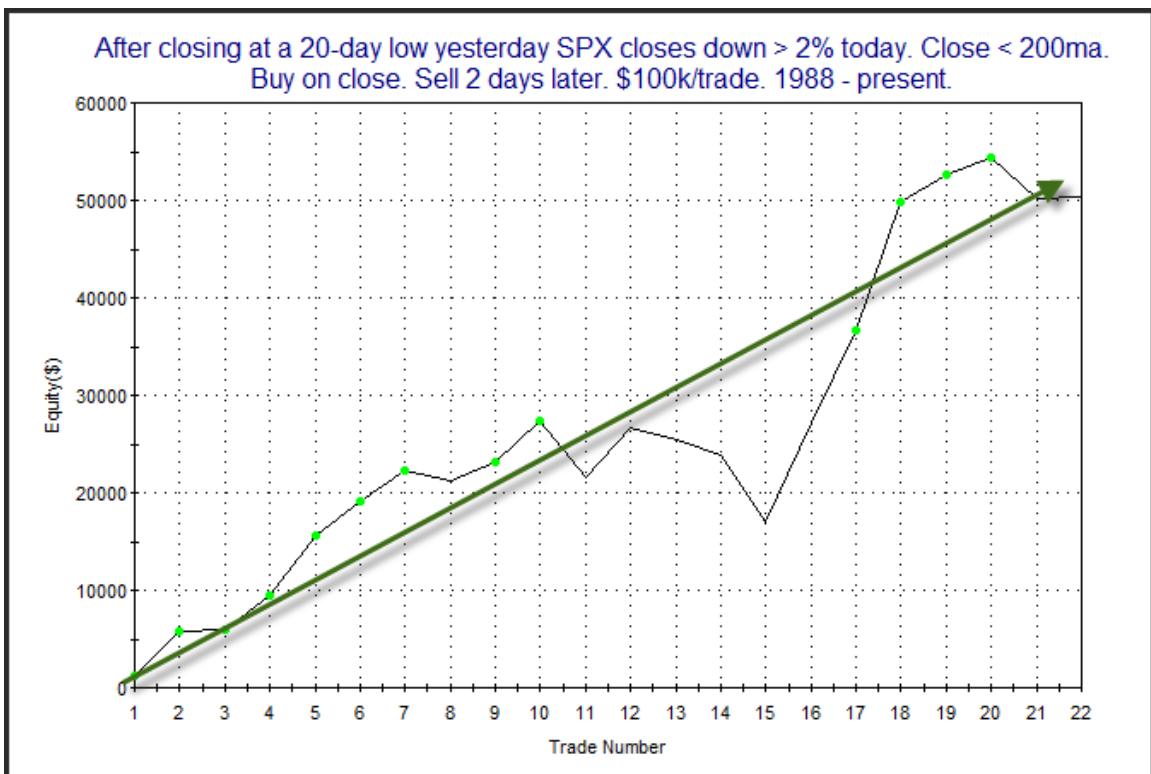
Another study that utilized the same concept came from the 4/21/09 subscriber letter. It looked for 2% drops after the SPX was already at a 20-day low. I filtered it a bit further tonight to require a close below the 200ma. Results are below.

After closing at a 20-day low yesterday SPX closes down > 2% today. Close < 200ma.  
Buy on close. Sell X days later. \$100k/trade. 1988 - 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	44,277.21	19	12	7	63.16	5,732.48	-3,501.79	1.64	2.81	2,330.38
4	28,122.79	20	13	7	65.00	4,703.71	-4,717.92	1.00	1.85	1,406.14
3	41,757.34	21	14	7	66.67	4,827.40	-3,689.46	1.31	2.62	1,988.44
2	50,279.96	22	16	6	72.73	4,446.75	-3,478.01	1.28	3.41	2,285.45
1	31,222.39	24	16	8	66.67	3,018.78	-2,134.76	1.41	2.83	1,300.93

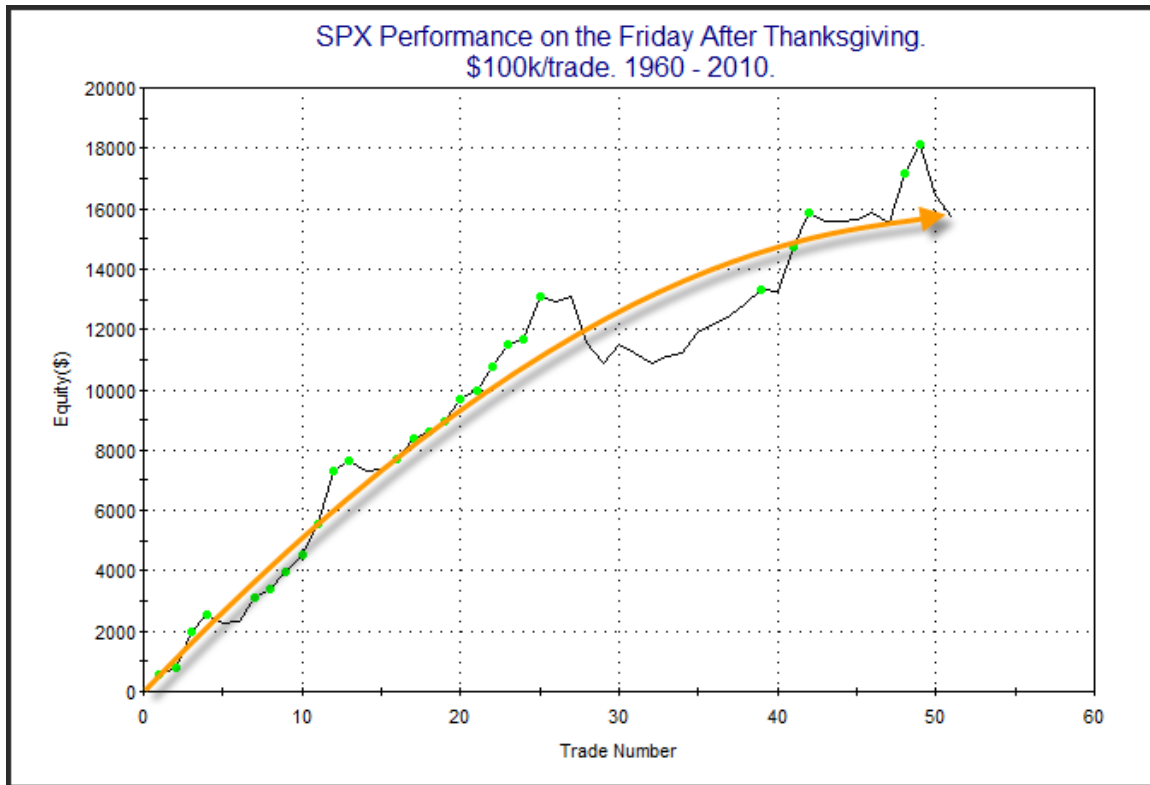
**23 of 24 instances (96%) closed above the entry price at some point in the next week. The lone failure triggered on 10/6/08.**

Here again we see strong consistency. The bounces are even more powerful in this case. Below is the equity curve.



This one is a little smoother. Between the 2 studies and the generally upsloping curves there certainly seems to be a short-term upside edge suggested by the oversold condition and Wednesday's acceleration south.

While seasonality hasn't helped, there is a positive bias still on Friday. That bias will turn to negative on Monday. Below is the "Friday After Thanksgiving" profit curve from the 11/21 letter a few days ago.



So while there remains a lot favoring the bullish case, the concerns from the last few days remain the same. The VIX (and the CBI) are showing no signs of panic despite the strongly oversold conditions. Either selling strong enough to induce a real panic will occur, or we will get the bounce without the panic. Odds seem to favor the 2<sup>nd</sup> scenario at this point, but we need to be aware of the 1<sup>st</sup> possibility.

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



While studies are mixed, the green Aggregator Line is still 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 now very far 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 extremely 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 Friday. Of course this could change if compelling bearish evidence emerges. The Differential Pivot will be 1,201.80 on Friday. This is 3.4% above Wednesday'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. The market is now so oversold that a bounce appears inevitable. There is still a chance that it will take a further washout before that bounce kicks in though. If the VIX or CBI were spiking I'd be looking to get

100% long. For now I am going to sit with my  $\frac{3}{4}$  position. The XIV trade idea took a hit on Wednesday, but is still holding up quite nicely. The 2 lots are now down just slightly. If the market does bounce without a VIX spike, then this position should benefit handsomely. If the market gets scared and the VIX spikes, then this position could suffer too.

***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.

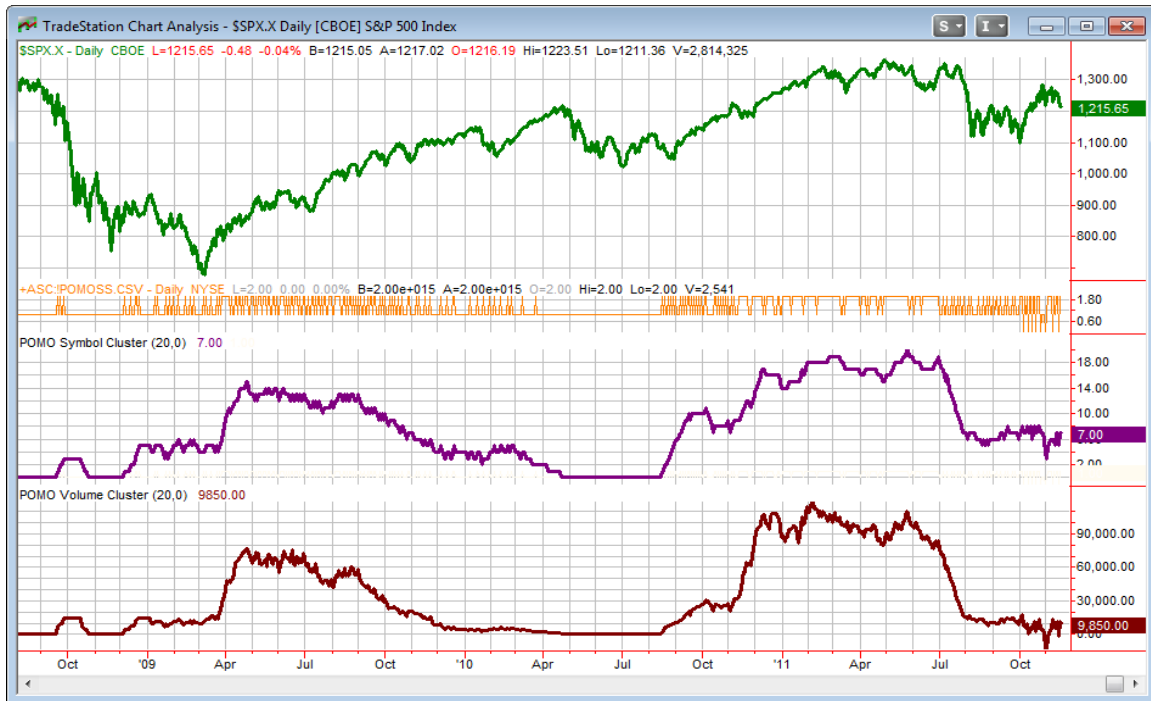
The last couple of days I've discussed the propensity of triangle breaks to reverse. As the triangle study available on the downloads page was designed the downside target for a "successful" triangle breakdown would be 1,153.29. But about 70% of the triangle breaks failed. This suggests we have a much 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**

<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>
SPY(1/4)	11/17/2011	\$123.85	\$116.56	-5.89%		Aggregator
XIV(1/2)	11/17/2011	\$5.21	\$4.99	-4.22%		VIX-based ETF systems
SPY(1/4)	11/18/2011	\$122.11	\$116.56	-4.55%		Aggregator
XIV(1/2)	11/21/2011	\$4.91	\$4.99	1.63%		VIX-based ETF systems
SPY(1/4)	11/21/2011	\$119.66	\$116.56	-2.59%		Aggregator

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