

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 2, 2011

Volume 4 Issue 233

Market Overview



Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Short	100% short SPY	Flat	Flat

Tonight's Research Points

- A down close with a 2-day RSI still above 85 has always been followed by more selling in SPY.
- The rally saw higher highs, lows, and closes. The pullback on Thursday only saw a lower close. This has been a short-term bullish sign historically.

Short-term Outlook

The Bottom Line

Expectations remain negative and the market is very strongly overbought. I am short SPY. But with expectations likely turning higher tomorrow I will take profits on any down close.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
December 2, 2011	Close only pullback after rally	1-4 days	Bullish	1.60%
December 2, 2011	Down close. RSI(2) > 85.	1-3 days	Bearish	-3.00%
December 1, 2011	3% rise on highest vol in 20	1-6 days	Bullish	
December 1, 2011	VXO 15%-20% below 10ma	1-3 days	Bearish	
Active - Long Term				
December 1, 2011	90% Up vol on 3rd day higher	1-14 days	Bullish	
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

The stock market took a bit of a breather on Thursday after the massive gains of the last few days. Indices finished mixed. The SPX was down 0.2% and the Russell 2000 fell 0.9% while the Nasdaq gained 0.2%. Breadth was moderately negative as the NYSE Up Issue % came in at 37% and the Up Volume % was 42%. Total NYSE volume was the lightest of the week.

Indications from the Quantifinder tonight were mixed. Historically, when SPY has become very overbought short-term and then pulled back extremely gently on day 1, that is often just the beginning of the pullback. The study below uses the 2-day RSI to measure how overbought the SPY is short-term. It requires a strongly overbought condition be in place at the close of a down day. For this to be achieved the SPY must be very strongly overbought to begin with, and then only pull back a little. The study is from the 7/15/10 letter. I have updated all the results.

SPY closes down on the day but the 2-day RSI > 85. Close < 200ma. Buy 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: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-23,056.84	9	2	7	22.22	1,372.61	2,144.90	-3,686.01	-6,354.30	0.37	0.11	-2,561.87
4	-18,566.53	9	2	7	22.22	1,565.58	2,047.00	-3,099.67	-5,692.05	0.51	0.14	-2,062.95
3	-19,608.43	9	0	9	0.00	0.00	0.00	-2,178.71	-4,948.40	0.00	0.00	-2,178.71
2	-17,291.07	9	1	8	11.11	418.30	418.30	-2,213.67	-4,065.25	0.19	0.02	-1,921.23
1	-6,271.21	9	3	6	33.33	335.52	667.74	-1,212.96	-2,217.05	0.28	0.14	-696.80

Only 9 instances is lower than I typically like to see, but all 9 of them closed lower 3 days later. And the size and consistency of the moves was also impressive. Below I have listed all 9 instances and their trade stats assuming a 3-day holding period.

SPY closes down on the day but the 2-day RSI > 85. Close < 200ma. Buy on close. Sell 3 days later. \$100k/trade. 1993 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
06/06/94	Buy	\$46.22	(0.39%)	\$129.78
06/09/94	Sell	\$46.04		(\$951.72)
11/07/00	Buy	\$143.75	(4.95%)	\$152.90
11/10/00	Sell	\$136.63		(\$5,017.90)
05/22/01	Buy	\$131.48	(2.57%)	\$0.00
05/25/01	Sell	\$128.10		(\$2,720.80)
07/03/01	Buy	\$124.10	(3.55%)	\$0.00
07/09/01	Sell	\$119.70		(\$4,065.25)
11/07/01	Buy	\$112.25	(0.20%)	\$1,628.70
11/12/01	Sell	\$112.03		(\$2,002.50)
12/06/01	Buy	\$117.34	(2.72%)	\$0.00
12/11/01	Sell	\$114.15		(\$2,930.88)
01/05/09	Buy	\$92.85	(1.95%)	\$1,723.20
01/08/09	Sell	\$91.04		(\$3,424.86)
07/14/10	Buy	\$109.65	(2.15%)	\$373.51
07/19/10	Sell	\$107.29		(\$3,124.73)
07/27/10	Buy	\$111.55	(1.15%)	\$241.92
07/30/10	Sell	\$110.27		(\$2,302.72)
Avg Run-up: 0.5% Avg Drawdown: -2.95% Max Run-up: 1.7%				

Despite the fairly low number of instances the consistency combined with the reward/risk considerations when looking at run-up and drawdown make this a very compelling short-side edge.

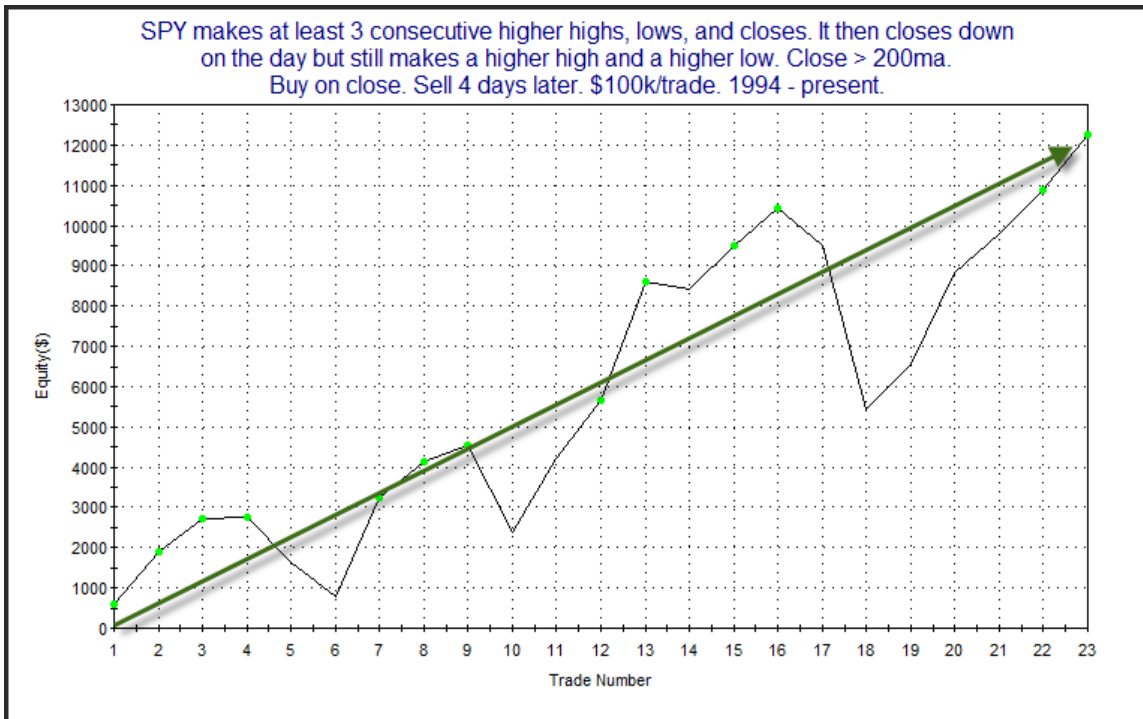
But there was also a price-based study that suggested perhaps an upside edge. The study below looks at the fact that the pullback only occurred on a closing basis and there was still a higher high and a higher low. It was last seen in the 4/26/11 letter. I have updated it below.

SPY makes at least 3 consecutive higher highs, lows, and closes. It then closes down on the day but still makes a higher high and a higher low. Close > 200ma.
Buy on close. Sell X 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: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	13,188.01	23	15	8	65.22	1,848.14	8,382.48	-1,816.77	-6,354.30	1.02	1.91	573.39
4	12,270.35	23	17	6	73.91	1,272.21	2,958.05	-1,559.53	-4,049.52	0.82	2.31	533.49
3	8,104.94	23	15	8	65.22	1,159.55	4,059.44	-1,161.03	-2,640.33	1.00	1.87	352.39
2	6,909.36	23	17	6	73.91	897.43	5,364.26	-1,391.17	-2,347.86	0.65	1.83	300.41
1	6,445.08	23	14	9	60.87	701.62	3,057.76	-375.28	-1,137.92	1.87	2.91	280.22

21 of 23 instances (91%) closed above the entry price at some point in the 4 days.

There are a decent number of instances in this case. Results here are compelling, but the consistency and size of the moves are not as powerful as the previous study. Below I have produced a profit curve assuming a 4-day exit.



The curve here is a bit choppy, with one loss as large as 4%. Still the upslope generally persists and the results as a whole appear worthy of consideration.

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



Tonight's bearish RSI study caused the green Aggregator Line to drop further 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 still very strongly 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 strongly overbought versus recent expectations. Historically this configuration has provided a downside edge. Bearish configurations can be seen on the chart whenever both lines close below 0. This all caused the Aggregator System to remain short at the close. This was posted to the Systems page shortly before the bell, and confirmed after the bell once the study numbers were crunched.

The short-term active studies are currently set up to turn net positive on Friday. This is largely thanks to the "3% gain on high volume" study from last night's letter. Of course this could change if bearish evidence emerges. The Differential Pivot will be 1,198.76 on Friday. This is 3.7% below Thursday's close. So it would take a drop of at least his much in order to move the Differential Line back into positive territory. That is highly

unlikely to happen in 1 day. It will still probably take a multi-day pullback or consolidation to wear off the overbought condition.

In a somewhat surprising move both my SPY short and my XIV long made money on Thursday. The mild selling didn't scare options traders and the VIX declined, helping out the XIV trade. Last night I felt the short-term downside opportunity appeared strong enough to attempt a short SPY trade. Still, I did not want to be shaken out of my XIV position since I felt the combination of my bullish intermediate-term outlook, seasonal volatility factors, and the very favorable contango in the futures term-structure all support the case for XIV appreciation over the intermediate-term. None of that has changed tonight.

But with expectations set to turn positive tomorrow I will look to exit the short SPY position if the market does indeed continue to sell off. This of course assumes new bearish evidence doesn't sway expectations negative. It is unlikely that strong bearish evidence would emerge on the 2nd down day in a row, so I am fairly confident that an exit on a down close would be a suitable place to take profits.

Intermediate-term Outlook (2 weeks – 2 months)– updated 11/28 – moderately bullish

Selling intensified this past week despite the bullish seasonality. The triangle breakdown from about a week and a half ago shows no sign of being a “false” breakdown (as 70% of them are) and instead is very close to the 1,150 projection target already. The move up, which was so strong in October, will soon be in jeopardy of failing unless the market can get its act together soon.

A couple of studies with intermediate-term consequences triggered this past week. Both appeared in the 11/22 letter and I have copied both of their results tables below. The 1st one was bullish. It looked at instances where drops of 1.75% or more surrounded a smaller SPX decline.

SPX closes down > 1.75% today and 2 days ago. Yesterday it was down but < 1.75%.
Buy on close. Sell X days later. \$100k/trade. 1961 - 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	69,714.98	20	17	3	85.00	4,958.12	-4,857.67	1.02	5.78	3,485.75
9	57,843.58	20	15	5	75.00	5,003.34	-3,441.29	1.45	4.36	2,892.18
8	55,882.82	20	15	5	75.00	4,838.73	-3,339.62	1.45	4.35	2,794.14
7	48,627.22	20	16	4	80.00	4,441.95	-5,610.98	0.79	3.17	2,431.36
6	51,365.59	20	16	4	80.00	3,933.71	-2,893.46	1.36	5.44	2,568.28
5	57,064.27	20	15	5	75.00	4,344.18	-1,619.70	2.68	8.05	2,853.21
4	40,353.37	20	18	2	90.00	3,089.24	-7,626.43	0.41	3.65	2,017.67
3	35,545.85	21	18	3	85.71	3,063.90	-6,534.80	0.47	2.81	1,692.66
2	28,025.00	21	15	6	71.43	2,585.03	-1,791.74	1.44	3.61	1,334.52
1	16,728.82	21	14	7	66.67	2,023.24	-1,656.65	1.22	2.44	796.61

The only instance that failed to close above the entry price at some point in the next 4 days triggered on 10/6/08.

The short-term is not playing out well for this study but it still could provide an intermediate-term influence.

The 2nd study considered the lackadaisical VIX that accompanied the strong selling. In contrast to the 1st study this one suggested bearish implications.

SPX closes under lower Bollinger Band. VIX closes < 5% above its 10ma.
Buy 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	-11,444.51	15	5	10	33.33	770.48	-1,529.69	0.50	0.25	-762.97
1	-4,673.56	17	6	11	35.29	970.08	-954.01	1.02	0.55	-274.92

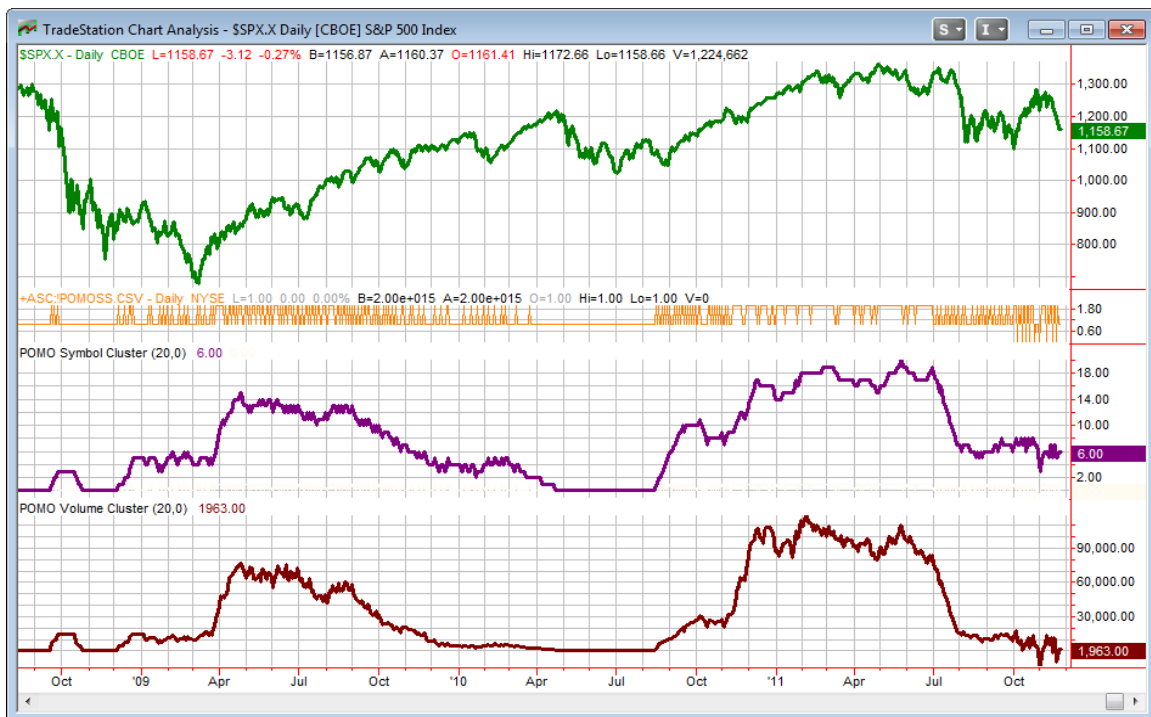
This one played out short-term, and it could continue to exert some influence.

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>



This week the Fed withdrew a net \$9.6 billion from the system with sales swamping purchases. As you can see the net volume over the last 20 days is now just \$1.9 billion injected, and earlier this week that number actually dipped into negative territory for the 2nd time in recent weeks.

The next operations schedule is set to be released on Wednesday the 30th, so we will see then how December shapes up for liquidity support (or resistance) from the Fed. Currently there is buying scheduled for Monday and Tuesday, and then selling on Wednesday. The schedule suggests Wednesday's selling will likely exceed the buying total of Monday and Tuesday.

There was a strong thrust in the market that began at basically the same time as Operation Twist. Perhaps that was initial excitement over the Fed's new plan. As it became clear

that Operation Twist would not provide the kind of liquidity support that QE1 and QE2 did the market seems to have floundered.

The intermediate-term is somewhat mixed. I'm still optimistic that the strong breadth and price thrusts that accompanied the rally in October were not false signals. It is unusual to see such early strength quickly dissipate and lead to another leg down for the market. Although seasonalities have not played out well recently, December is typically a strong month for the market. I'm inclined to maintain a bullish posture at this point, though I have reduced the strength of my outlook some.

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.](#)

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
XIV(1/2)	11/21/2011	\$4.91	\$5.84	18.94%		looking to hold a while
SPY(s)(1/4)	12/1/2011	\$125.00	\$124.97	0.02%		cover on close <= \$124.97

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.