

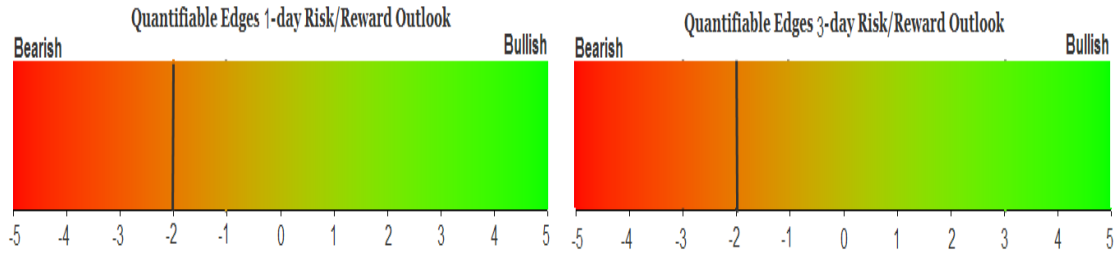
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 5, 2011

Volume 4 Issue 234

Market Overview



Signals Overview

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

Tonight's Research Points

- The large spike to a 10-day high and down close on Friday is a pattern that is often followed by a rise over the next 1-7 days.
- The VIX has been hitting 20-day lows while the SPY has failed to make 20-day highs. Historically this has been bearish for both the short and intermediate-term.
- The Fed is scheduled to withdraw liquidity from the market over the next month, which may act as a drag on the market.

Short-term Outlook

The Bottom Line

There still appears to be a short-term downside edge, but the overbought condition of the market will wear off tomorrow unless it moves solidly higher. I will look for a quick short play to take advantage of this edge.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
December 5, 2011	10-high 1% up from yest. Down close.	1-7 days	Bullish	3.10%
December 5, 2011	3 20-day VIX lows. No SPY 20-high	1-4 days	Bearish	-3.45%
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 5, 2011	POMO scheduled to turn negative	int term	Bearish	
December 5, 2011	3 20-day VIX lows. No SPY 20-high	1-20 days	Bearish	-7.30%
December 1, 2011	90% up day on at least 3rd day higher	1-14 days	Bullish	
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	
Dropped Tonight				
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	

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

The Evidence

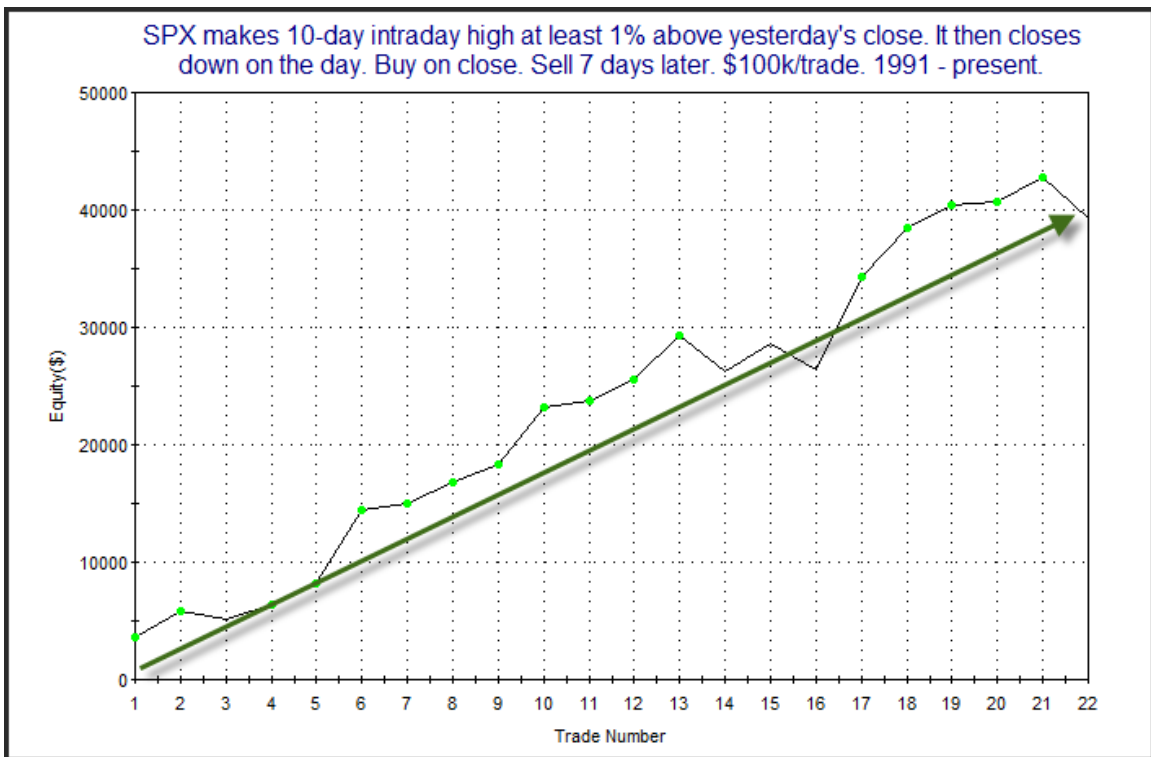
A big gap up on Friday couldn't hold. After fading lower throughout most of the day the SPX moved into negative territory shortly before the close. It finished down less than 1 point. The Nasdaq finished up less than 1 point. The only real mover was the Russell 2000 which gained 0.6%. Breadth was moderately positive as the NYSE up Issues % came in at 60% and the Up Volume % was 58%. Total NYSE volume rose slightly from Thursday's level.

Indications were mixed on Friday, and as I'll discuss later the market is in a tricky place right now. One study with bullish implications that appeared in the Quantifinder was from the 9/21/11 subscriber letter. It looked at times where the SPX made a 10-day intraday high that was more than 1% above the previous day's close, but then closed down on the day. I have updated the results below.

SPX makes 10-day intraday high at least 1% above yesterday's close. It then closes down on the day. Buy on close. Sell X days later. \$100k/trade. 1991 - 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
10	17,170.48	22	14	8	63.64	2,507.51	5,850.63	-2,241.83	-6,485.62	1.12	1.96	780.48
9	16,334.16	22	16	6	72.73	2,359.22	8,190.60	-3,568.90	-8,537.38	0.66	1.76	742.46
8	33,620.02	22	17	5	77.27	2,809.80	10,424.04	-2,829.30	-5,865.61	0.99	3.38	1,528.18
7	39,314.97	22	18	4	81.82	2,712.21	7,918.68	-2,376.21	-3,460.27	1.14	5.14	1,787.04
6	33,428.25	22	16	6	72.73	2,887.56	6,923.40	-2,128.78	-4,235.49	1.36	3.62	1,519.47
5	24,577.11	24	17	7	70.83	2,533.80	9,111.96	-2,642.51	-4,550.71	0.96	2.33	1,024.05
4	19,946.07	24	16	8	66.67	2,298.79	6,097.05	-2,104.33	-3,248.62	1.09	2.18	831.09
3	9,875.76	25	15	10	60.00	2,026.25	3,979.80	-2,051.80	-5,449.78	0.99	1.48	395.03
2	13,963.84	25	16	9	64.00	1,936.29	5,340.72	-1,890.75	-6,019.99	1.02	1.82	558.55
1	3,625.09	25	15	10	60.00	1,030.93	3,198.36	-1,183.89	-2,932.39	0.87	1.31	145.00

The numbers here all appear solidly bullish. After what seems to be an initial 2-day thrust, the typical instance appears to pause before continuing this rally through day seven. Below is a profit curve that assumes a 7-day holding period.



The last instance didn't work out too well, but the persistence over time has been very good. Overall it appears this setup seems to contain a quantifiable upside edge.

This next study was last seen in the 6/17/10 subscriber letter. It considers the fact that the VIX is making new 20-day lows but the SPY is failing to make any 20-day highs. The last time I ran this test I used SPX instead of SPY. I used SPY this time instead on accident. In doing so I noticed it provided one extra instance. Because NYSE stocks have a staggered opening, SPY sometimes posts more extreme intraday levels than SPX. I decided to use the SPY results this time because the one extra instance, which took place in 2002, seemed to be nicely representative. Results are below.

VIX makes new 20-day intraday low for at least the 3rd time in the last 10 days. SPY has 0 20-day highs in the last 10 days. Close > 200ma. Buy SPY 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: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
20	-35,398.63	7	0	7	0.00	0.00	0.00	-5,056.95	-13,729.17	0.00	0.00	-5,056.95
19	-33,262.44	7	0	7	0.00	0.00	0.00	-4,751.78	-11,729.34	0.00	0.00	-4,751.78
18	-30,456.99	7	0	7	0.00	0.00	0.00	-4,351.00	-11,751.81	0.00	0.00	-4,351.00
17	-29,968.12	7	0	7	0.00	0.00	0.00	-4,281.16	-9,976.68	0.00	0.00	-4,281.16
16	-27,874.01	7	0	7	0.00	0.00	0.00	-3,982.00	-11,429.74	0.00	0.00	-3,982.00
15	-25,084.37	7	0	7	0.00	0.00	0.00	-3,583.48	-7,475.02	0.00	0.00	-3,583.48
14	-21,089.26	7	0	7	0.00	0.00	0.00	-3,012.75	-5,620.16	0.00	0.00	-3,012.75
13	-12,598.15	7	1	6	14.29	1,729.92	1,729.92	-2,388.01	-4,763.64	0.72	0.12	-1,799.74
12	-17,967.42	7	1	6	14.29	1,055.36	1,055.36	-3,170.46	-5,437.74	0.33	0.06	-2,566.77
11	-14,699.80	7	1	6	14.29	1,175.04	1,175.04	-2,645.81	-6,441.40	0.44	0.07	-2,099.97
10	-21,571.90	7	1	6	14.29	623.52	623.52	-3,699.24	-7,287.77	0.17	0.03	-3,081.70
9	-18,755.90	7	2	5	28.57	134.21	181.86	-3,804.86	-6,546.26	0.04	0.01	-2,679.41
8	-19,099.88	7	2	5	28.57	772.78	1,004.56	-4,129.09	-7,033.11	0.19	0.07	-2,728.55
7	-13,505.54	7	2	5	28.57	1,571.35	1,904.32	-3,329.65	-5,168.10	0.47	0.19	-1,929.36
6	-15,692.09	7	2	5	28.57	1,849.59	1,957.16	-3,878.25	-5,679.36	0.48	0.19	-2,241.73
5	-18,971.87	8	2	6	25.00	1,674.15	2,066.62	-3,720.03	-6,276.62	0.45	0.15	-2,371.48
4	-19,916.09	8	1	7	12.50	147.22	147.22	-2,866.19	-5,639.97	0.05	0.01	-2,489.51
3	-14,761.18	8	1	7	12.50	1,201.02	1,201.02	-2,280.31	-5,782.28	0.53	0.08	-1,845.15
2	-6,607.35	9	3	5	33.33	779.42	1,136.10	-1,789.12	-3,707.55	0.44	0.26	-734.15
1	-928.64	12	5	7	41.67	785.53	1,861.04	-693.75	-2,202.06	1.13	0.81	-77.39

Instances are a bit low, but they all head lower. The edge appears to be substantially negative in both the short and long-term. Below I have listed all instances assuming a 4-day holding period.

VIX makes new 20-day intraday low for at least the 3rd time in the last 10 days.
 SPY has 0 20-day highs in the last 10 days. Close > 200ma.
 Buy SPY on close. Sell 4 days later. \$100k/trade. 1999 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
02/15/01	Buy	\$133.34	(5.65%)	\$0.00
02/22/01	Sell	\$125.81		(\$7,729.68)
07/02/01	Buy	\$124.13	(3.57%)	\$0.00
07/09/01	Sell	\$119.70		(\$4,089.40)
12/26/01	Buy	\$115.36	0.15%	\$1,203.74
01/02/02	Sell	\$115.53		(\$1,342.30)
01/03/02	Buy	\$116.84	(1.09%)	\$983.25
01/09/02	Sell	\$115.57		(\$1,282.50)
03/27/02	Buy	\$114.57	(1.25%)	\$1,046.40
04/03/02	Sell	\$113.14		(\$2,101.52)
11/20/02	Buy	\$92.37	(0.73%)	\$2,055.80
11/26/02	Sell	\$91.70		(\$811.50)
02/25/08	Buy	\$137.33	(2.56%)	\$1,317.68
02/29/08	Sell	\$133.82		(\$3,312.40)
12/16/08	Buy	\$91.88	(5.25%)	\$598.40
12/22/08	Sell	\$87.06		(\$6,952.32)

I see nothing alarming here (for bears, that is). The downside edge appears nicely consistent and run-up is quite small compared to drawdown.

Below I have listed the seven instances that triggered and qualified for a 20-day holding period.

VIX makes new 20-day intraday low for at least the 3rd time in the last 10 days.
 SPY has 0 20-day highs in the last 10 days. Close > 200ma.
 Buy SPY on close. Sell 20 days later. \$100k/trade. 1999 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
02/15/01	Buy	\$133.34	(13.75%)	\$0.00
03/16/01	Sell	\$115.01		(\$14,141.12)
07/02/01	Buy	\$124.13	(2.24%)	\$0.00
07/31/01	Sell	\$121.35		(\$5,940.90)
12/26/01	Buy	\$115.36	(1.57%)	\$2,277.58
01/25/02	Sell	\$113.55		(\$2,892.44)
03/27/02	Buy	\$114.57	(4.45%)	\$1,046.40
04/25/02	Sell	\$109.47		(\$5,101.20)
11/20/02	Buy	\$92.37	(3.48%)	\$3,981.76
12/19/02	Sell	\$89.16		(\$4,079.14)
02/25/08	Buy	\$137.33	(1.81%)	\$1,317.68
03/25/08	Sell	\$134.85		(\$8,197.28)
12/16/08	Buy	\$91.88	(8.14%)	\$2,796.16
01/15/09	Sell	\$84.40		(\$11,054.08)

Here again we see strongly negative results with moves lower swamping moves higher.

I should note that I also examined this study above the 200ma. It was more of a tossup above the 200ma. The net results without any filter would have been negative and would have led to a negative Aggregator anyway (though less so than you will see below).

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



With both studies taken into account the green Aggregator Line remained solidly negative. 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 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. Personally, I was expecting the Aggregator line to turn positive at the bell on a down close. But even with the last-minute dive the bearish edge remained in place.

The short-term active studies are currently set up to remain net negative on Monday. Of course this could change if bullish evidence emerges. The Differential Pivot will be inverted at 1,248.02 on Monday. This is *0.3% above* Friday's close. So unless the SPX rises at least this much, the Differential Line will flip to positive at the close, signaling the market has moved from short-term overbought to short-term oversold versus recent expectations.

The market is in a very tricky place here. We remain quite overbought, but that condition is wearing off with the sideways trading of the last 2 days. And it will be totally worn off if we trade sideways or lower for 1 more day. Studies are mixed as well, with fairly compelling evidence for both the bulls and the bears.

The Aggregator is negative and I am moderately inclined to favor the pullback scenario. Unfortunately I exited my small short position near the close on Friday. So I will look to put a small short position back on if the SPX opens higher or shows some intraday strength that puts it above the Differential Pivot. I'll also look to exit the trade at the end of the day if we close back down below the pivot.

Intermediate-term Outlook (2 weeks – 2 months)– updated 12/5 – neutral

There were some pretty incredible gains this past week thanks to huge up days on Monday and Wednesday. The net impact was a rally of over 7%. This put an end to the Thanksgiving collapse and moved some of our long positions into strongly positive territory. The strong rally this week seems to have faltered the last two days a little below both the October highs and the 200ma. It may be a battle to get through these levels, but if the market can manage to do so I would view that as a very positive sign.

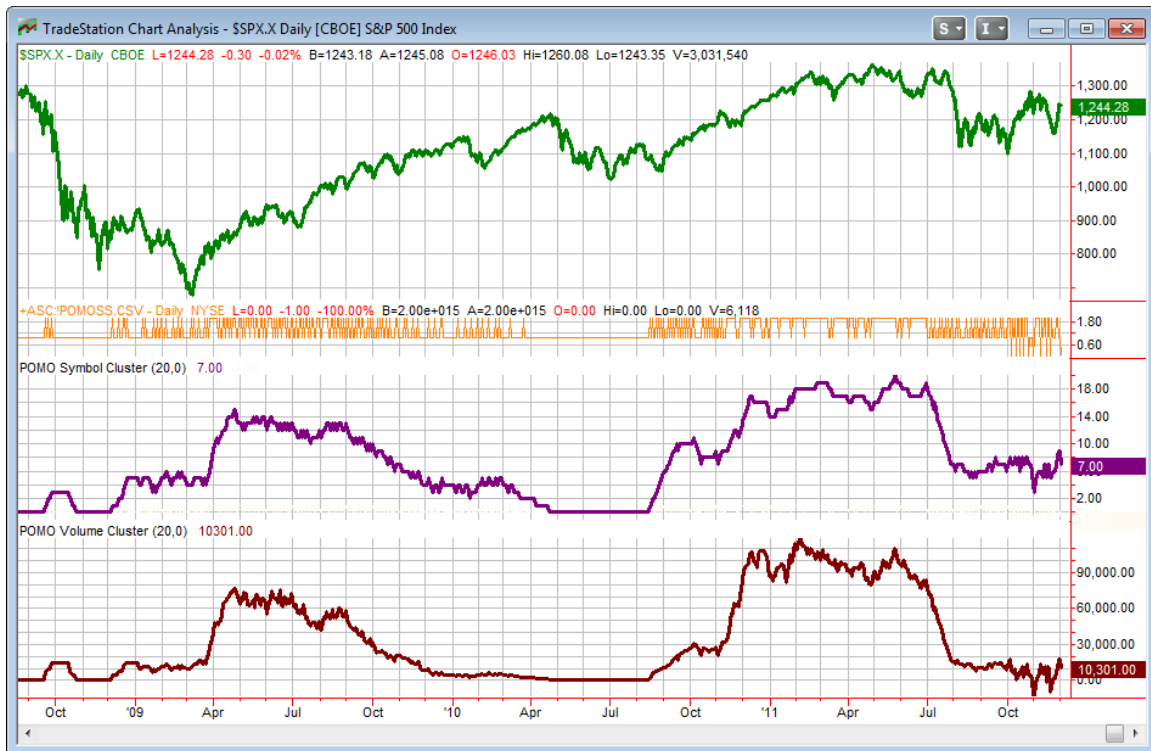
There were two studies that triggered this week with possible intermediate-term implications. One of them is the VIX-based study that I reviewed in the short-term section above. The other one is from the 12/1/11 subscriber letter. It looked at strong upside breadth days that occurred on at least the third day in a row. I've copied the results table below.

SPX closes higher for at least the 3rd day in a row. The NYSE Up Volume % > 90%. Buy SPX on close. Sell X days later. \$100k/trade. 10/20/87 - 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: Max Winning Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
15	43,333.80	18	13	5	72.22	4,168.55	-2,171.47	11,124.12	-5,239.30	1.92	4.99	2,407.43
14	42,075.37	18	16	2	88.89	2,937.15	-2,459.53	8,025.22	-2,533.16	1.19	9.55	2,337.52
13	34,051.50	19	15	4	78.95	2,552.31	-1,058.30	7,484.65	-3,373.70	2.41	9.04	1,792.18
12	32,093.31	19	15	4	78.95	2,548.20	-1,532.42	7,583.70	-2,355.10	1.66	6.24	1,689.12
11	29,374.57	19	12	7	63.16	2,842.28	-676.11	8,671.60	-1,283.04	4.20	7.21	1,546.03
10	29,216.99	19	14	5	73.68	2,729.94	-1,800.43	10,921.96	-2,533.02	1.52	4.25	1,537.74
9	25,604.49	19	14	5	73.68	2,371.00	-1,517.91	8,397.62	-2,298.27	1.56	4.37	1,347.60
8	20,826.00	19	14	5	73.68	2,355.73	-2,430.86	7,394.80	-3,753.26	0.97	2.71	1,096.11
7	24,039.48	19	13	6	68.42	2,492.90	-1,394.69	9,599.94	-2,724.73	1.79	3.87	1,265.24
6	17,806.90	19	12	7	63.16	2,424.31	-1,612.11	5,066.85	-3,497.62	1.50	2.58	937.21
5	11,390.12	19	14	5	73.68	1,903.05	-3,050.52	4,428.90	-6,695.61	0.62	1.75	599.48
4	10,059.40	19	14	5	73.68	1,600.67	-2,470.00	5,800.13	-6,719.68	0.65	1.81	529.44
3	1,625.89	19	12	7	63.16	1,450.11	-2,253.63	3,641.54	-5,298.72	0.64	1.10	85.57
2	4,579.56	19	15	4	78.95	933.72	-2,356.54	4,479.84	-8,004.64	0.40	1.49	241.03
1	5,424.53	19	9	10	47.37	961.74	-323.12	2,860.08	-1,140.30	2.98	2.68	285.50

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 added a net \$1.1 billion to the system with purchases edging out sales. The net volume over the last 20 days is now \$10.3 billion injected, which is near the upper end of its recent range.

The bad news is that the Fed released its December POMO schedule and while there are \$45 billion in scheduled purchases there are \$52 billion in scheduled sales. This means we will likely see a contraction in liquidity over the next month. (Though the news out of Europe suggests global liquidity may increase, perhaps aiding the global markets and helping to lift the US as well.)

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. The intermediate-term active studies list is showing a fair amount of both bullish and bearish indications. Most concerning from this week are the VIX-based study which has shown large declines over the intermediate-term and the POMO activity both now and over the next month. With the market bumping up against resistance and I am inclined to change my stance to neutral. Should we continue to rally and breakout above the October highs then I will probably turn back to bullish.

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 @ 125.25 LIMIT. Based on the short-term outlook above. This level is just above the Differential Pivot.

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	\$124.86	0.11%		covered on close

I am very close to exiting the XIV trade and may do so if the market pops higher in the next day or so. The intermediate-term is now less inviting and the VIX is making 20-day lows and could easily spike a bit if the SPX pulls back. The strong contango does remain in place and should help XIV, but it won't be enough if the market begins to crater.

I will cover the SPY position at the close if I am filled intraday and the SPX closes at or below the Differential Pivot of 1,248.02.

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