

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 8, 2011

Volume 4 Issue 237

## Market Overview



## Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Flat	50% Long XIV	Flat	Flat

## Tonight's Research Points

- The strong move in the SOX while the Nasdaq declined is a setup that is often followed by a rise the next day.

## *Short-term Outlook*

### *The Bottom Line*

I don't have much clarity and I plan to exit my short position until a more substantial edge again emerges.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
December 6, 2011	Nasdaq up 4 days < 200ma	1-2 days	Bearish	-1.80%
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	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	
<b>Active - Long Term</b>				
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	
<b>Dropped Tonight</b>				
<b>December 2, 2011</b>	<b>Close only pullback after rally</b>	<b>1-4 days</b>	<b>Bullish</b>	<b>1.60%</b>
December 1, 2011	VXO 15%-20% below 10ma	1-3 days	Bearish	

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

***The Evidence***

After trading lower most of the day a late surge led to more mixed results. The SPX rose 0.2% while the Nasdaq finished flat with a 0.01% decline and the Russell 2000 lost 0.1%. Breadth was slightly positive as the NYSE Up Issues % came in at 53% and the Up Volume % was 59%. Total NYSE volume edged up from Tuesday's level but was unremarkable.

The market is in a very tricky place right now for number of reasons. The most obvious of this is that it seems to be in a holding pattern ahead of the news out of the European summit. News perceived as good will almost certainly spark a quick rally while bad news could lead to a quick tumble. But it isn't just the news that is placing the market in a tricky place. Indicators are showing some conflict as well. There were a substantial number of studies tonight that triggered in the Quantifinder. Unfortunately most of them depended upon one of at least two things - the VIX and the 200ma.

While the S&P rose on Wednesday for the third day in a row, the VIX has also risen all three days. I showed some studies last night suggesting the rising VIX behavior was bearish. While those studies are still active for another day, more detailed look today is not showing anything new and compelling.

There've been 10 other unique times when the SPX and VIX have both risen three days in a row. Returns over the next few days were mixed and showed no edge. It's also worth considering why the VIX is rising along with the SPX. I believe the primary reason is that as we approach European summit news option traders have been buying premium more aggressively. Once the news is out this anxiety will lessen and we should see VIX action return to a more normal pattern.

The SPY managed to close above its 200ma on Wednesday, but the SPX did not. There were several priced-based studies that utilized the 200ma. For instance, there was one that looked at three consecutive up days and an SPX close under the 200ma, and there was another that looked at the one day price action in SPY but required a close above the 200ma. The first study was bearish and the second study was bullish. While I have found great value in utilizing the 200ma, I would rather utilize studies without it as a filter when trading so close to it. Ignoring the 200ma for any of these studies would have dramatically reduced or eliminated the edge.

So while there appeared to be quite a bit of evidence to consider as we approach the close, I have decided to ignore most of the studies due to their construction and the unique current market circumstances.

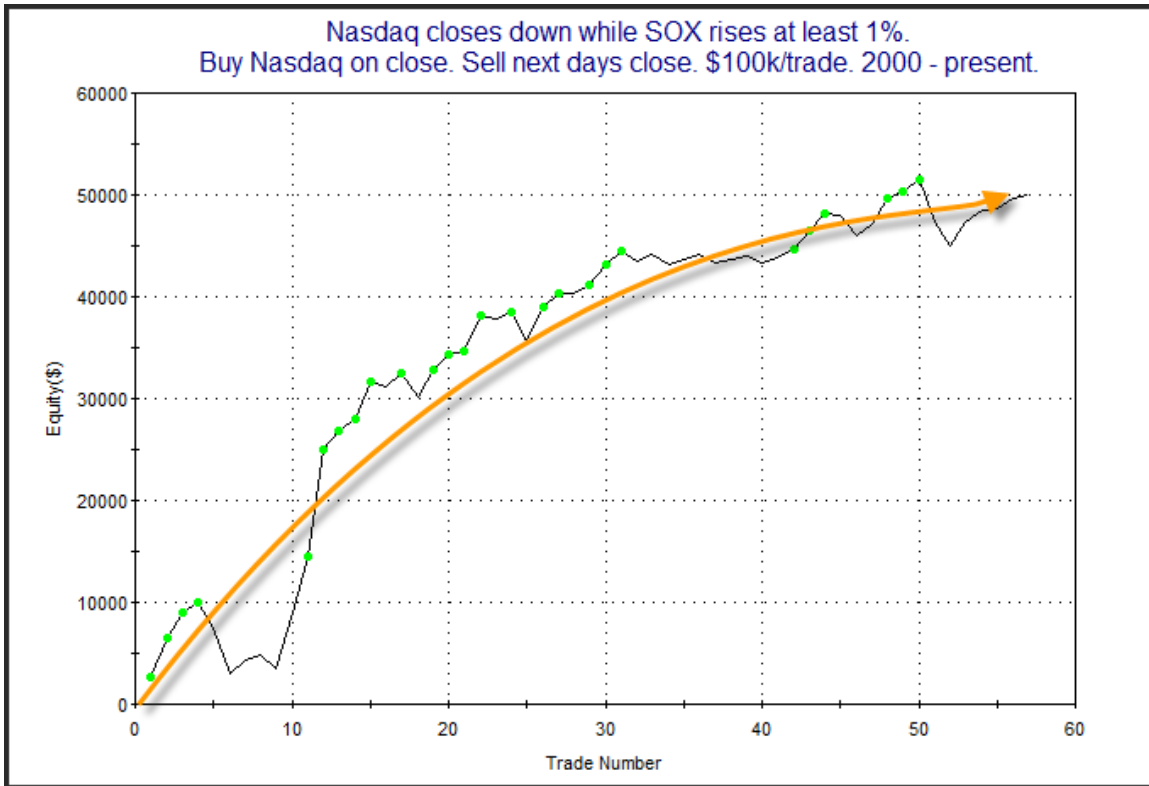
One study I did find compelling enough to take under consideration was from the 11/7/11 subscriber letter. It looked at times where the NASDAQ composite declined while the SOX rose at least 1%. Below is an excerpt from the 11/7/11 letter. All results have been updated.

*One potential positive... is the strong performance by the semiconductor index (SOX) in the face of the Nasdaq decline. The study below has been updated.*

Nasdaq closes down while SOX rises at least 1%.  
Buy Nasdaq on close. Sell X days later. \$100k/trade. 2000 - 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	11,529.44	52	30	22	57.69	3,331.01	-4,018.22	0.83	1.13	221.72
4	34,568.67	55	32	23	58.18	3,147.68	-2,876.40	1.09	1.52	628.52
3	37,927.21	55	34	21	61.82	2,893.56	-2,878.75	1.01	1.63	689.59
2	47,460.93	56	35	21	62.50	2,725.04	-2,281.68	1.19	1.99	847.52
1	49,583.98	56	40	16	71.43	1,904.30	-1,661.76	1.15	2.86	885.43

The stats table seems to suggest a 1-day upside edge for the Nasdaq. The “% Profitable”, “Profit Factor” and “Avg Trade” are all impressive. Below is a profit curve that assumes a 1-day holding period.



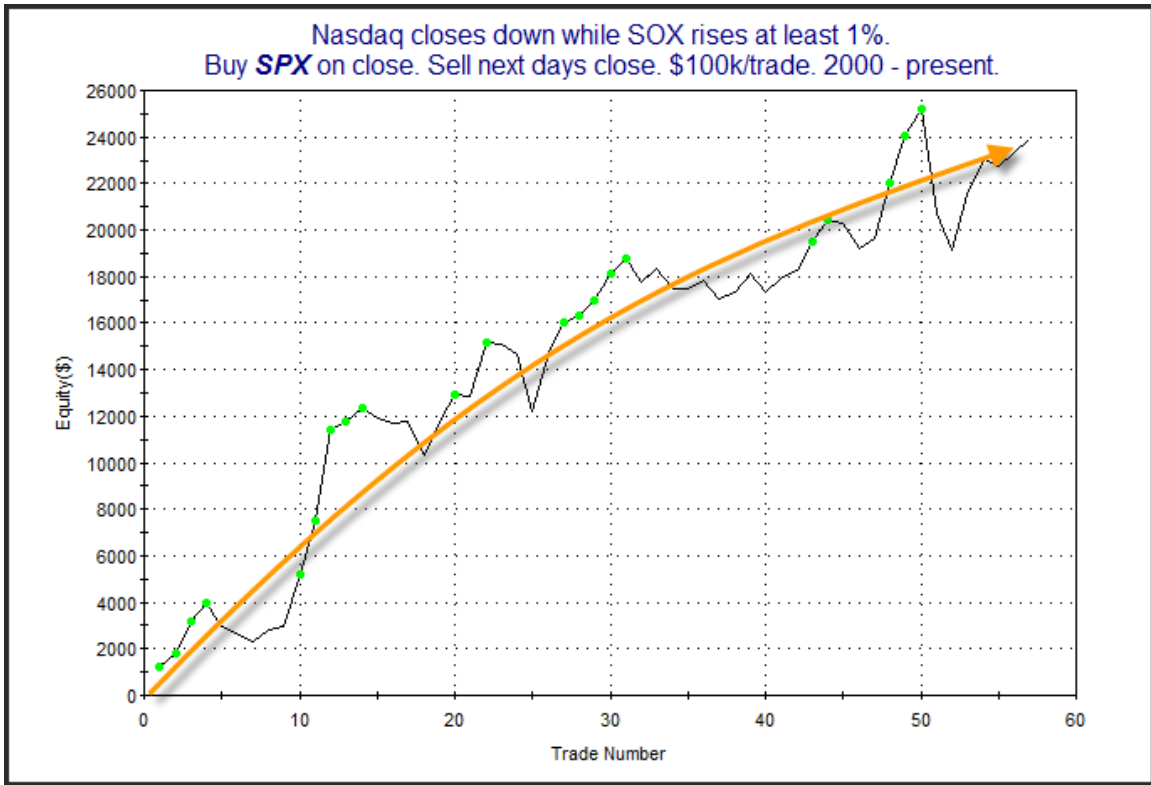
There appears to be some flattening in the curve as some of the biggest winners appeared early on. Still, the slope remains generally up and the study seems to be worth consideration.

Of course the Aggregator anticipates SPX movement not Nasdaq movement, though the two are highly correlated. I decided to see how the SPX has performed when the setup triggered.

TradeStation Performance Summary <span style="float: right;">Collapse ↕</span>			
All Trades			
Total Net Profit	\$23,923.82	Profit Factor	2.34
Gross Profit	\$41,838.93	Gross Loss	(\$17,915.11)
Total Number of Trades	57	Percent Profitable	66.67%
Winning Trades	38	Losing Trades	19
Even Trades	0		
Avg. Trade Net Profit	\$419.72	Ratio Avg. Win:Avg. Loss	1.17
Avg. Winning Trade	\$1,101.02	Avg. Losing Trade	(\$942.90)
Largest Winning Trade	\$3,863.25	Largest Losing Trade	(\$4,520.40)

Based on these results it appears the SPX has benefitted as well. The strength of the upside edge isn't quite as strong though. The average instance sees a rise of about 0.4% instead of the 0.9% shown in the Nasdaq results. Traders looking to take advantage of the setup may want to consider trading the Nasdaq rather than the S&P in cases like this.

I also ran the SPX profit curve and have included it below.



*The curve here appears a little more consistent than the Nasdaq profit curve.*

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



With tonight's studies taken into account the green Aggregator Line turned positive. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line is still well below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are bullish but the SPX is overbought versus recent expectations. This is considered a neutral configuration. Neutral configurations can be seen on the chart whenever both lines close on opposite sides of zero. This caused the Aggregator System to turn neutral.

The short-term active studies are currently set up to remain positive on Thursday. Of course this could change if more bearish evidence emerges. The Differential Pivot will be 1,250.45 on Thursday. This is 0.8% below Wednesday's close. So the SPX will need to close down at least this much in order for the Differential Line to close above 0.

I am basically neutral now and inclined to step aside. I suspect the market will move strongly in the next couple of days. While I may miss out on anticipating this move, we will likely see substantial edges emerge following the move. So on Thursday I will be looking to exit my current SPY short position.

**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.

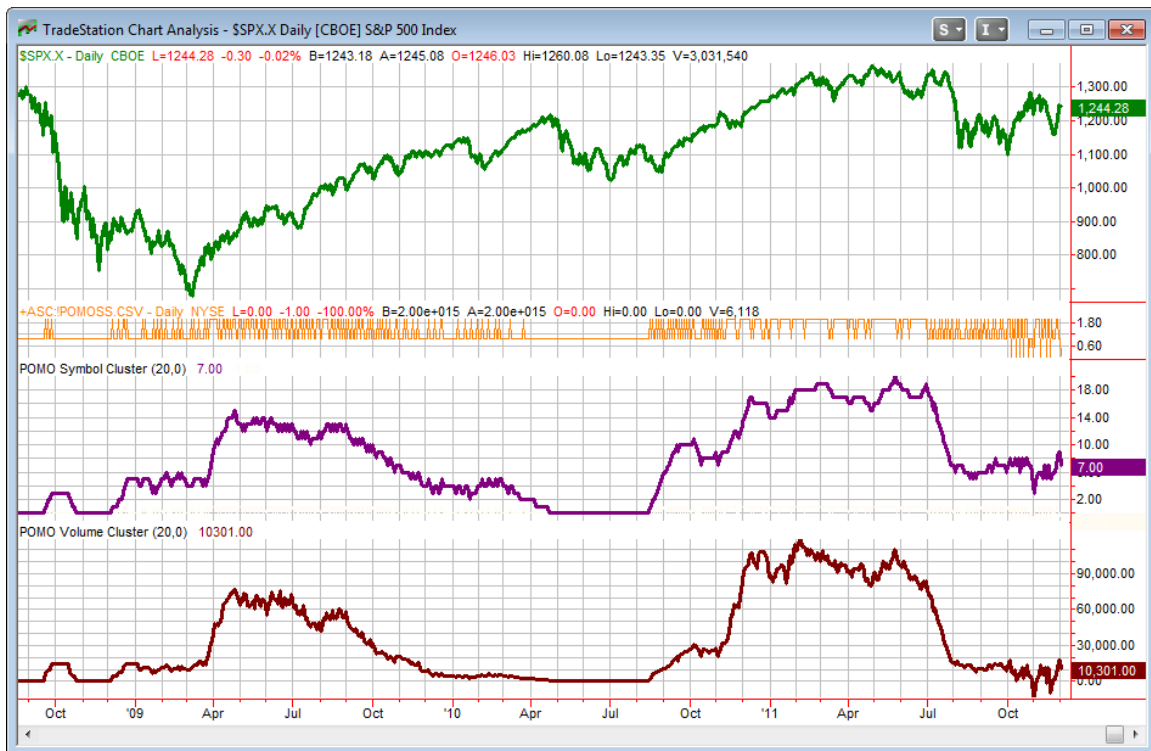
SPX closes higher for at least the 3rd day in a row. The NYSE Up Volume % > 90%. Buy SPX on close. Sell X days later. \$100k/trade. 10/20/87 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing 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 3<sup>rd</sup> 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.*

*None tonight.*

### **Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
XIV(1/2)	11/21/2011	\$4.91	\$5.70	16.09%	\$4.99	looking to hold a while
SPY(s)(1/4)	12/5/2011	\$126.84	\$126.73	0.09%		Aggregator

*I will cover the SPY position at a limit near Wednesday's close.*

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