

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 14, 2011

Volume 4 Issue 241

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- Strong starts and big reversals down on Fed Days are typically followed by a bounce in the next few days.
- The SPY pattern of a gap up, move higher, and then a poor close at a 10-day low has consistently led to a short-term bounce.
- Another consistent indication of a bounce is the 2 weak breadth days we've just seen consecutively.

## *Short-term Outlook*

### *The Bottom Line*

The Aggregator is now suggesting an upside edge. I will look to take advantage of it with long exposure.

**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 14, 2011	Fed Day rise and reversal down	1-3 days	Bullish	
December 14, 2011	Gup up and reverse to a 10-day low	1-2 days	Bullish	
December 14, 2011	33% Up Issues 2 days in a row	1-2 days	Bullish	
December 13, 2011	Unfill gap both ways	1-4 days	Bearish	
December 12, 2011	December Op-Ex Seasonally Strong	1-5 days	Bullish	
<b>Active - Long Term</b>				
December 12, 2011	Seasonal strength into year end	thru 1/2	Bullish	
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>				
December 13, 2011	Down 1% pre-Fed	1 day	Bullish	
December 5, 2011	10-high 1% up from yest. Down close.	1-7 days	Bullish	3.10%
December 9, 2011	Gap & crap	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***

Morning enthusiasm got beat down after the afternoon Fed announcement. The major indices all finished lower. The SPX lost 0.9%, the NASDAQ declined 1.3%, and the Russell 2000 dropped 2.1%. Breadth was strongly negative as the NYSE Up Issues % came in at 25% and the Up Volume % was 18%. Total NYSE volume rose to the highest level in the last few days.

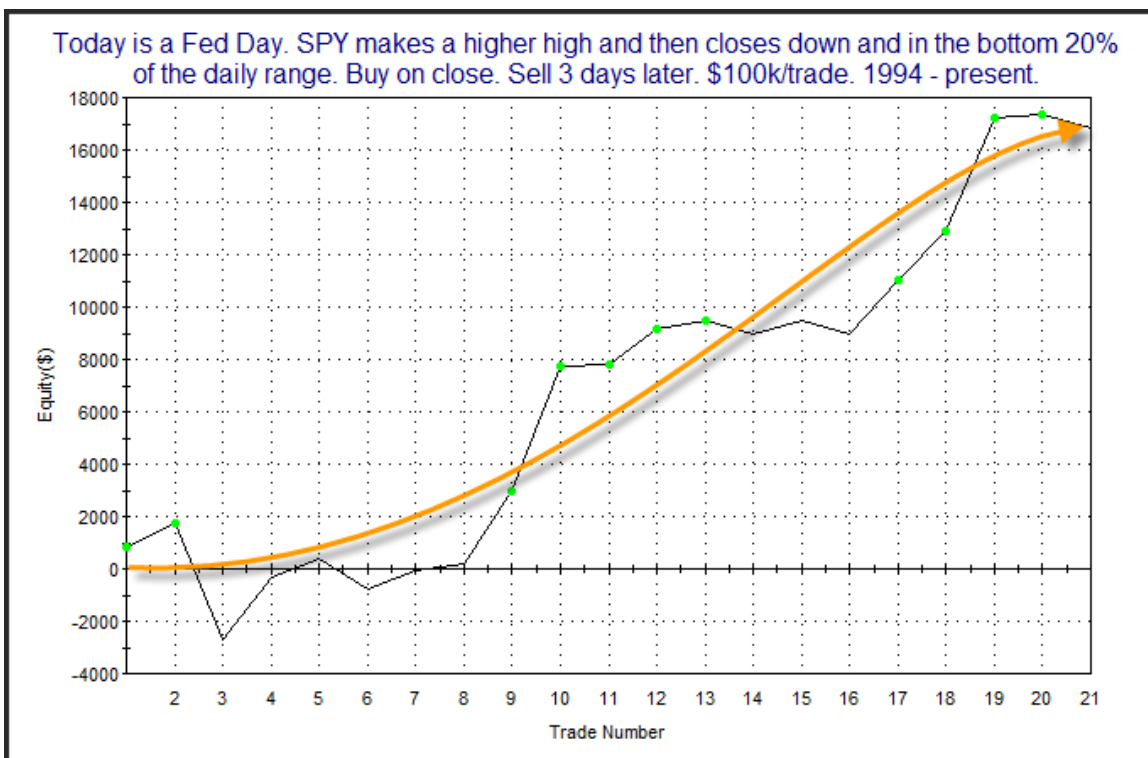
It's a little unusual to see such strong selling on a fed day, especially after the previous day was weak. But the market was strong up until the announcement, and that's really the point where fed day action becomes unreliable. I've studied other instances where fed days have seen moves higher and then a large reversal and weak close. Below are a few Fed-based studies whose criteria were met with today's action. This first one simply requires a higher high and then a negative close in the bottom 20% of the day's range. It was last seen in the 6/23/11 subscriber letter. All results have been updated.

Today is a Fed Day. SPY makes a higher high and then closes down and in the bottom 20% of the daily range. Buy on close. Sell X days later. 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	17,755.08	21	14	7	66.67	2,161.57	6,086.66	-1,786.69	-5,393.25	1.21	2.42	845.48
4	22,750.35	21	13	8	61.90	2,439.90	7,872.42	-1,121.04	-3,667.41	2.18	3.54	1,083.35
3	16,814.65	21	16	5	76.19	1,496.99	4,772.75	-1,427.43	-4,441.50	1.05	3.36	800.70
2	12,428.36	21	15	6	71.43	1,548.59	5,087.19	-1,800.08	-2,695.00	0.86	2.15	591.83
1	13,095.54	21	15	6	71.43	1,335.42	3,649.75	-1,155.97	-2,906.82	1.16	2.89	623.60

19 of 21 instances (90%) closed above the Fed Day close at some point in the next 3 days.

The stats here suggest a bullish edge over the next 3-4 days. To get a better feel for how the edge has played out over time I produced an equity curve using a 3-day exit strategy.



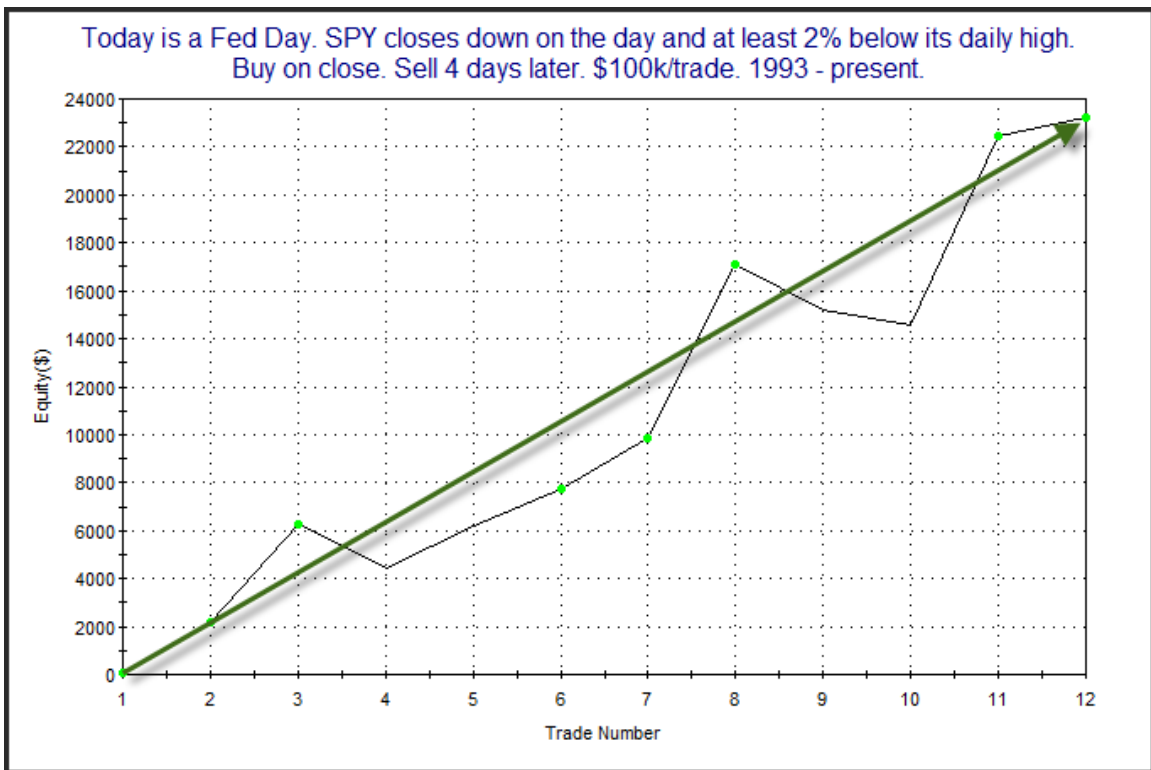
For a setup with such a high winning percentage the equity curve sure appears choppy. It does go from lower left to upper right, so it isn't a complete disaster, but it does dampen my enthusiasm a little bit for this setup.

This next study was last seen in the 9/22/11 letter. It also looks for a strong intraday reversal south. Results here are also updated.

Today is a Fed Day. SPY closes down on the day and at least 2% below its daily high.  
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	18,402.99	12	8	4	66.67	3,132.40	6,086.66	-1,664.06	-2,628.75	1.88	3.76	1,533.58
4	23,245.10	12	9	3	75.00	3,065.17	7,872.42	-1,447.15	-1,919.84	2.12	6.35	1,937.09
3	19,763.00	12	9	3	75.00	2,414.01	4,772.75	-654.36	-1,128.61	3.69	11.07	1,646.92
2	12,871.99	12	9	3	75.00	2,271.69	5,087.19	-2,524.41	-2,695.00	0.90	2.70	1,072.67
1	6,536.59	12	9	3	75.00	1,596.87	3,649.75	-2,611.74	-3,230.89	0.61	1.83	544.72

Instances here are lower than I would prefer, but the overall numbers appear strongly positive. I figured it was at least worth looking at the equity curve.



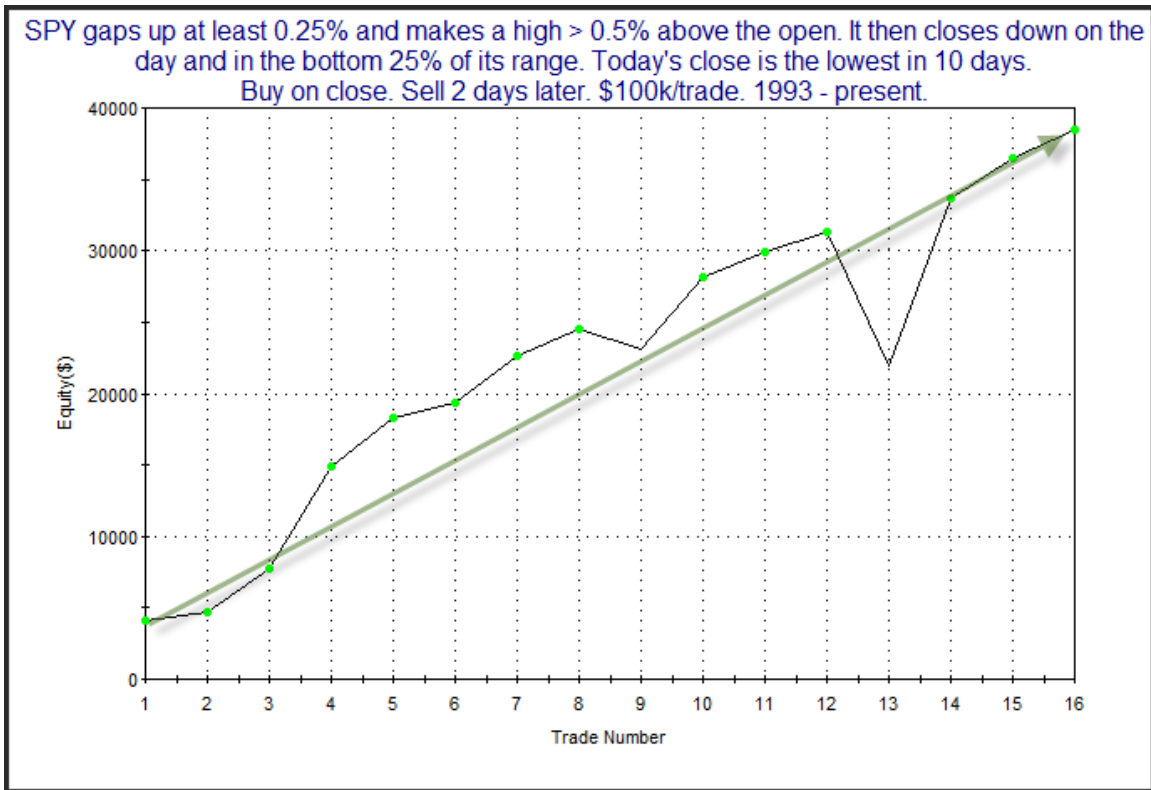
While a bit choppy, this curve does appear more appealing than the last. Between the decent curve here and the numbers for the first test I feel that the Fed-based edge is worth considering.

But even without Fed-day considerations SPY was carving out a very bullish short-term pattern.

SPY gaps up at least 0.25% and makes a high > 0.5% above the open. It then closes down on the day and in the bottom 25% of its range. Today's close is the lowest in 10 days.  
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	19,926.60	15	9	6	60.00	5,997.46	13,737.50	-5,675.09	-19,787.04	1.06	1.59	1,328.44
4	18,025.00	16	9	7	56.25	5,009.07	12,275.00	-3,865.23	-17,793.84	1.30	1.67	1,126.56
3	35,422.36	16	13	3	81.25	3,798.66	10,083.30	-4,653.42	-11,623.98	0.82	3.54	2,213.90
2	38,501.97	16	14	2	87.50	3,517.60	11,736.30	-5,372.19	-9,340.86	0.65	4.58	2,406.37
1	13,084.52	16	12	4	75.00	1,809.71	5,962.50	-2,158.01	-5,091.72	0.84	2.52	817.78

Instances are just slightly light here, but the numbers are overwhelmingly bullish. Let's take a look at the equity curve assuming a 2-day holding period.



Aside from the one sharp dip results appear to have been strong and steady.

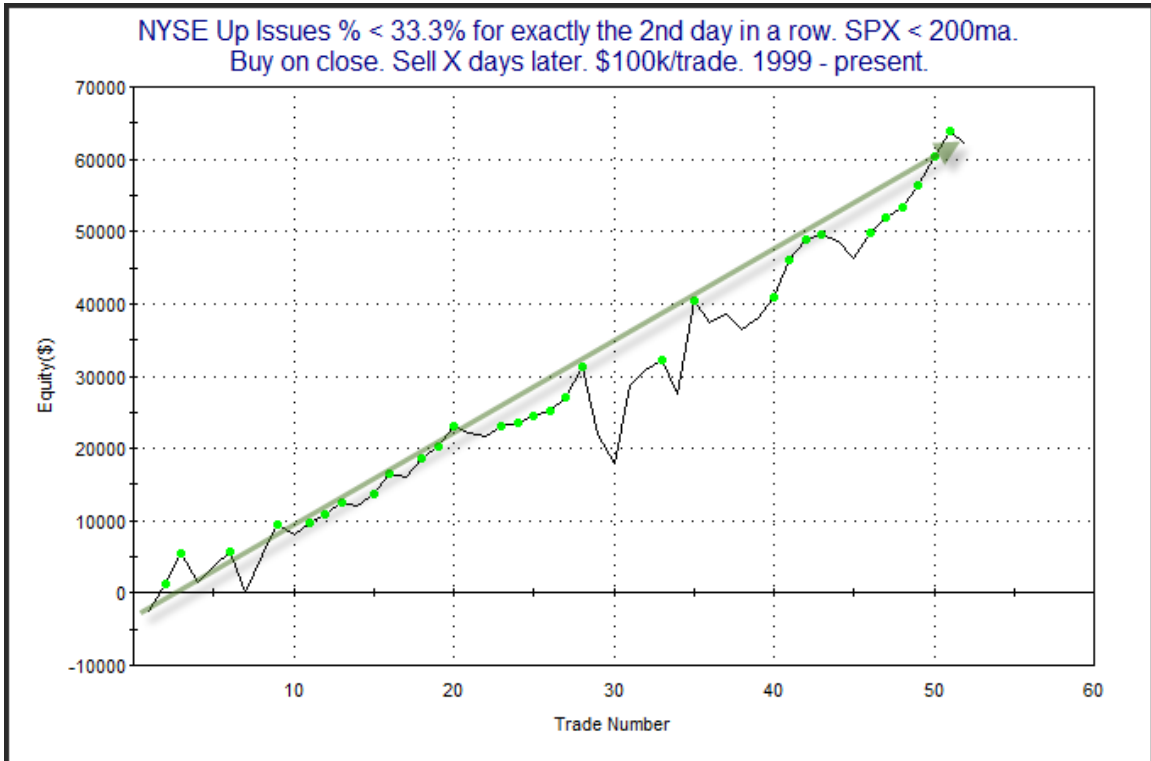
The study below was last seen in the 11/2/11 subscriber letter. It is one that I have shown many times over the last few years, and it has been very dependable. The study looks for two days of strongly lopsided negative breadth and a close under the 200ma. I have updated the statistics.

**NYSE Up Issues % < 33.3% for exactly the 2nd day in a row. SPX < 200ma.  
Buy 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
5	65,614.91	46	32	14	69.57	3,332.79	8,771.85	-2,931.03	-9,199.19	1.14	2.60	1,426.41
4	41,796.41	49	30	19	61.22	3,124.31	8,971.36	-2,733.31	-6,961.50	1.14	1.80	852.99
3	45,861.77	52	33	19	63.46	3,447.18	14,708.85	-3,573.43	-11,723.40	0.96	1.68	881.96
2	61,973.47	52	36	16	69.23	2,946.61	12,693.50	-2,756.52	-9,320.67	1.07	2.41	1,191.80
1	43,970.42	52	34	18	65.38	2,041.06	11,683.71	-1,412.54	-6,506.24	1.44	2.73	845.59

**49 of 52 instances (94%) closed above the entry price  
at some point in the next week.**

For the considerable sample size and low number of criteria these results are astonishingly consistent. The stat at the bottom of the table is what seems most striking. Below is an equity curve using a 2-day exit.



As I've mentioned in the past I especially like this study because it has produced such consistently positive returns in a downtrending environment. That's fairly unusual to see.

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



With tonight's studies taken into account the green Aggregator Line popped strongly 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 also 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. Historically, this setup has provided an upside edge. It can be seen on the chart whenever both lines close above zero. This caused the Aggregator System to change from flat to long.

The expectations of the short-term active studies are currently set up to close positive again on Wednesday. Of course this could change if bearish evidence emerges. The Differential Pivot will be at 1,255.47 on Wednesday. This is over 2.4% above Tuesday's

close. So the SPX will need to rally at least this much in order for the Differential Line to fall below 0. While anything is possible, this is unlikely to happen in one night. A more likely scenario would be a multi-day move higher.

I always like seeing solid pullback setups right as we are entering a period of strong seasonality. The aggregator is suggesting a bounce and I'll be looking to start scaling into a position to take advantage of it. Details in the trade ideas section below.

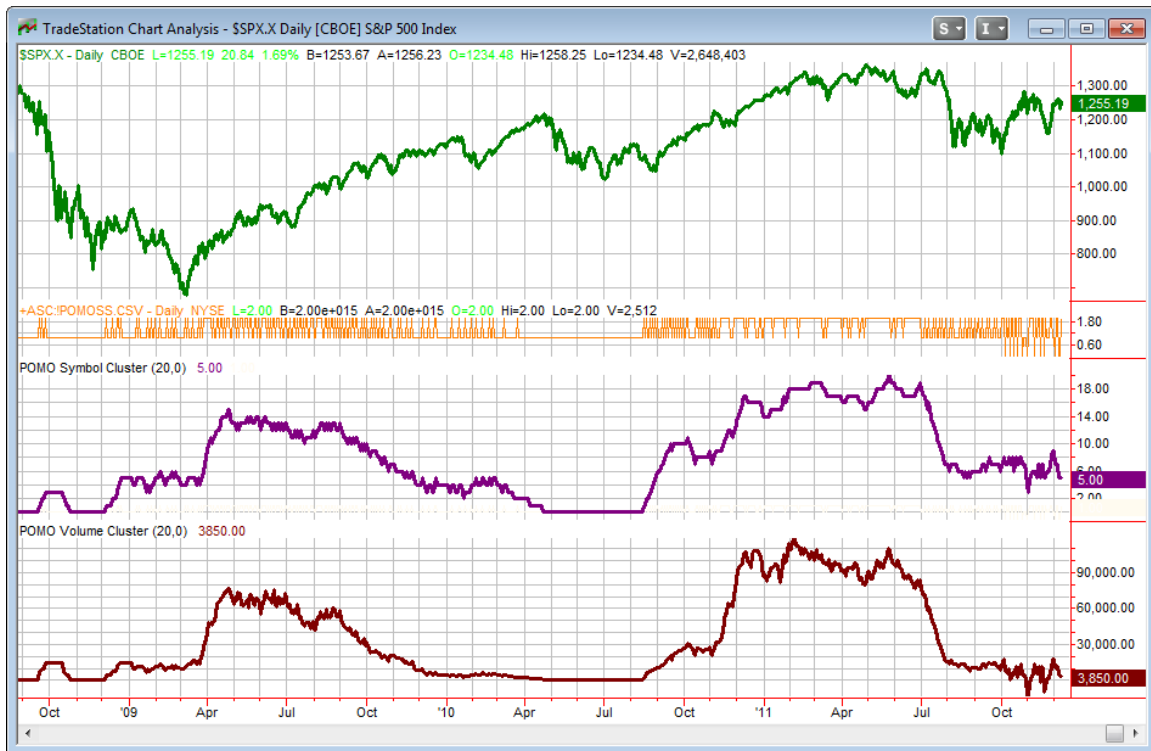
***Intermediate-term Outlook (2 weeks – 2 months)– updated 12/12 – somewhat bullish***

More gains this past week have the market testing the 200ma. The next stop would be the October highs. Aside from the seasonal studies shown in the short-term section above there wasn't anything that triggered from an intermediate-term standpoint this past week.

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 \$6.3 billion to the system with purchases quite a bit stronger than sales. The net volume over the last 20 days is now \$3.6 billion injected, which is in the middle of its recent range.

The bad news is that the December POMO schedule worsens in the next several weeks and outflows are expected.

The intermediate-term is somewhat mixed. The intermediate-term active studies list is showing a fair amount of both bullish and bearish indications. With seasonality strong over the next few weeks I am inclined to give a slight edge to the bulls. Of course this could change as things evolve this week.

## **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 buy 1/4 index position @ \\$123.05 limit.](#) Based on short-term outlook above.*

## **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>
XIV(1/2)	11/21/2011	\$4.91	\$5.81	18.33%	\$4.99	looking to hold a while

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