

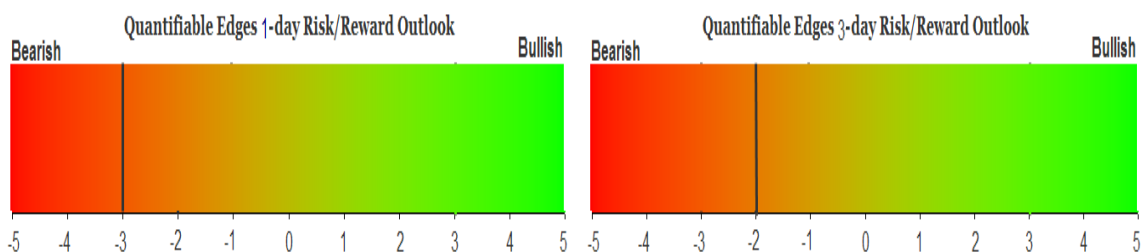
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 21, 2011

Volume 4 Issue 246

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- The 90% up day immediately after the 90% down day suggest a 1-day bearish edge.
- The large unfilled gap up with a close > the open shows bearish potential, but the edge has not played out well recently.

## Short-term Outlook

### The Bottom Line

The Aggregator as flipped from bullish to bearish but the downside edge only appears temporary. I'm flat and not looking to take on new exposure just yet.

## 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 21, 2011	90% Down then 90% Up	1 day	Bearish	
<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 20, 2011	5 closes in bottom 50%	1 day	Bullish	

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

### *The Evidence*

Boom! All the troubles were declared over – if for just a day. The market rocketed higher as the SPX gained 3.0%, the Nasdaq rose 3.2% and the Russell 2000 rallied 4.2%. Breadth was extremely positive as the NYSE Up Issues % came in at 87% and the Up Volume % was 97%. Total NYSE volume rose a little from Monday’s level, but still wasn’t particularly high.

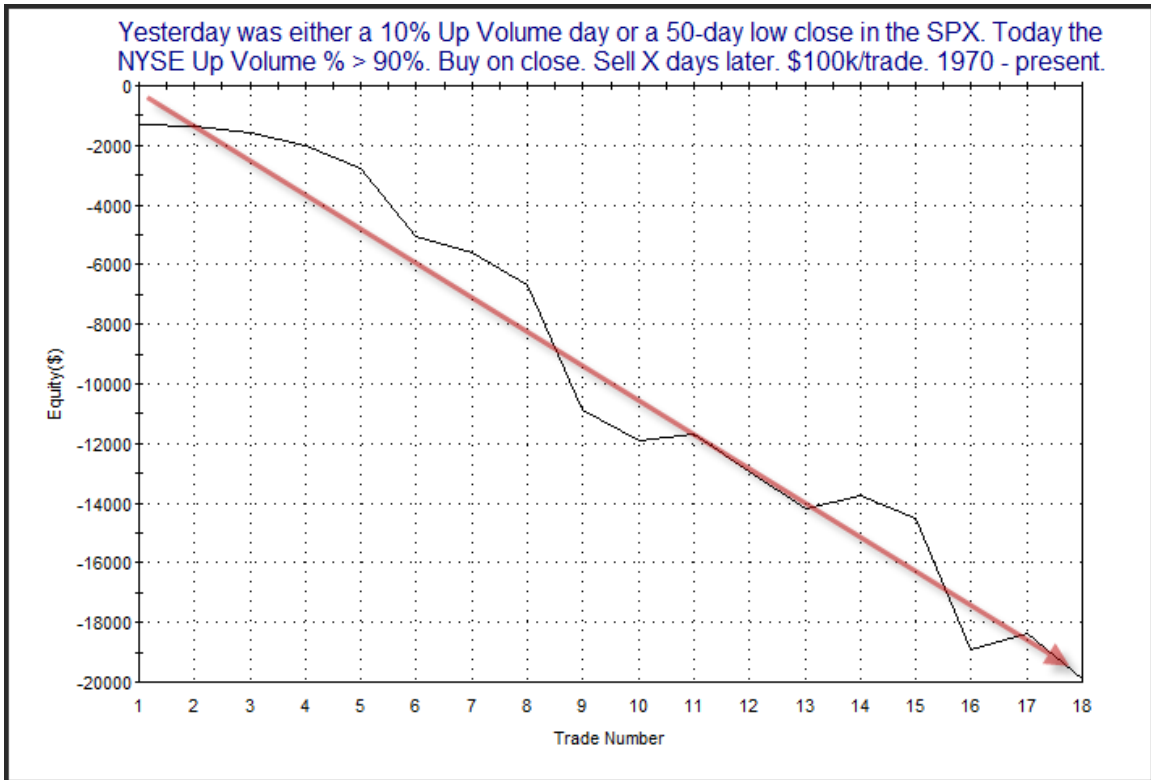
There were a few studies tonight in the Quantifinder that looked at the big move on moderate volume. While some appeared bearish the one that most closely resemble the current setup was neutral. So I won’t be discussing them tonight. But there is more to talk about.

The study below, which was last shown just recently in the 12/12/11 letter suggests very strong up days that follow very strong down days rarely follow through for a 2<sup>nd</sup> day. Results are updated.

Yesterday was either a 10% Up Volume day or a 50-day low close in the SPX. Today the NYSE Up Volume % > 90%. Buy on close. Sell X days later. \$100k/trade. 1970 - present.

TradeStation Performance Summary <span style="float: right;">Collapse ^</span>			
All Trades			
Total Net Profit	(\$19,869.11)	Profit Factor	0.06
Gross Profit	\$1,172.28	Gross Loss	(\$21,041.39)
Total Number of Trades	18	Percent Profitable	16.67%
Winning Trades	3	Losing Trades	15
Even Trades	0		
Avg. Trade Net Profit	(\$1,103.84)	Ratio Avg. Win:Avg. Loss	0.28
Avg. Winning Trade	\$390.76	Avg. Losing Trade	(\$1,402.76)
Largest Winning Trade	\$524.45	Largest Losing Trade	(\$4,400.45)

The numbers here all appears strongly bearish. Below is the equity curve.



The strong steady downmove appears to confirm the bearish edge. The study is a little bit odd in that the parameters were originally set up as an either/or in order to see more instances. I looked at the 9 instances that triggered via the 90% down/90% up criteria rather than the 50-day low. The stats for those instances were similar to the stats for the whole group. Seven of nine instances closed down the next day and the average trade led to a loss of 1.3%. So while the setup is a little odd, I am comfortable using it. And to further illustrate, I have included below the 9 instances that triggered via 90% down / 90% up.

Yesterday was either a 10% Up Volume day or a 50-day low close  
in the SPX. Today the NYSE Up Volume % > 90%.  
Buy on close. Sell X days later. \$100k/trade. 1970 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
03/06/07	Buy	\$1,395.41	(0.25%)	\$408.25
03/07/07	Sell	\$1,391.97		(\$338.67)
08/29/07	Buy	\$1,463.76	(0.42%)	\$317.56
08/30/07	Sell	\$1,457.64		(\$850.68)
11/13/08	Buy	\$911.29	(4.17%)	\$609.31
11/14/08	Sell	\$873.29		(\$4,513.69)
05/21/10	Buy	\$1,087.69	(1.29%)	\$205.66
05/24/10	Sell	\$1,073.65		(\$1,364.09)
06/02/10	Buy	\$1,098.38	0.41%	\$663.39
06/03/10	Sell	\$1,102.83		(\$597.87)
11/24/10	Buy	\$1,198.35	(0.75%)	\$0.00
11/26/10	Sell	\$1,189.40		(\$816.72)
08/09/11	Buy	\$1,172.53	(4.42%)	\$0.00
08/10/11	Sell	\$1,120.76		(\$4,634.20)
08/11/11	Buy	\$1,172.64	0.53%	\$1,394.00
08/12/11	Sell	\$1,178.81		(\$161.50)
12/09/11	Buy	\$1,255.19	(1.49%)	\$0.00
12/12/11	Sell	\$1,236.47		(\$2,207.26)
<b>Avg Drawdown: -\$1,721 Avg Run-up: \$400</b> <b>MAX Run-up \$1,394</b>				

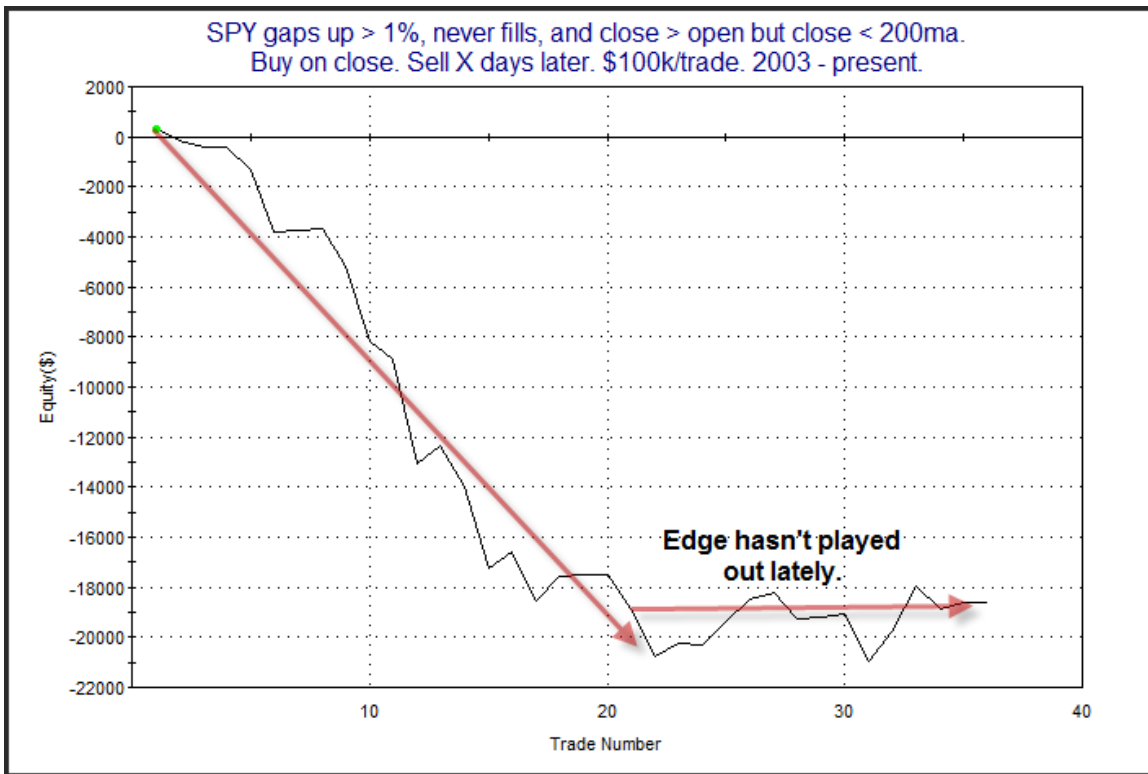
The high downside risk vs the small upside reward makes this especially compelling for the bears.

Another study that I took a fresh look at tonight is the one below, which was last seen in the 11/14/11 subscriber letter. It examined strong gaps up that continue to make gains. All results are updated.

SPY gaps up > 1%, never fills, and close > open but close < 200ma.  
Buy on close. Sell X days later. \$100k/trade. 2003 - present.

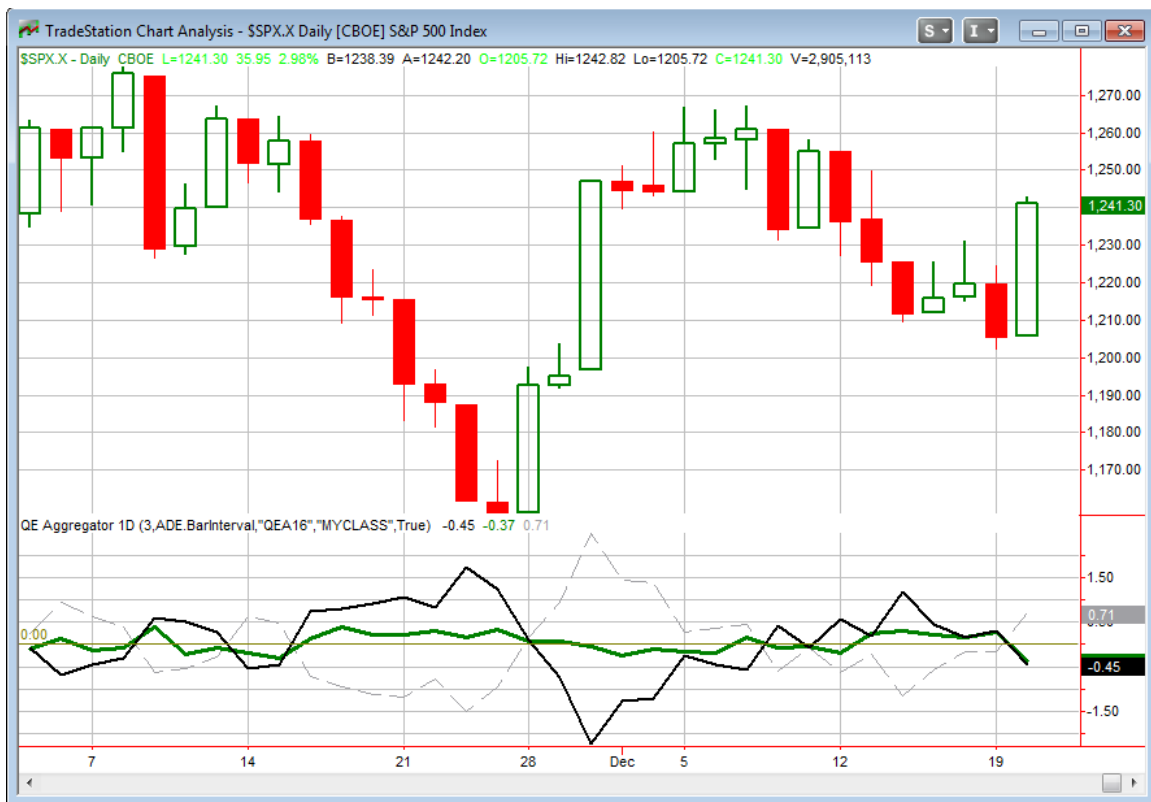
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-30,637.68	33	16	17	48.48	3,007.37	8,323.85	-4,632.68	-15,038.32	0.65	0.61	-928.41
4	-33,938.74	34	15	19	44.12	2,566.01	5,110.65	-3,812.05	-11,911.24	0.67	0.53	-998.20
3	-14,823.20	34	16	18	47.06	2,380.01	5,950.56	-2,939.08	-7,473.88	0.81	0.72	-435.98
2	-22,553.79	36	19	17	52.78	1,599.73	4,633.44	-3,114.63	-11,171.38	0.51	0.57	-626.49
1	-18,617.82	36	18	18	50.00	498.73	1,821.56	-1,533.06	-4,198.90	0.33	0.33	-517.16

The stats here look fairly compelling. And when you look out 4-5 days they appear quite impressive. When I looked at the equity curves in the past I found that the only one that had any real appeal was the 1-day curve. But looking at the 1-day curve below I see that it too appears to be losing its edge.



With the recent flattening I have decided to put this study on hold for now and not include it on tonight's short-term active list. This leaves us with just the 1<sup>st</sup> study to go by.

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



Like this old song, the green Aggregator and black Differential lines dipped together tonight. The negative green Aggregator means net expectations from the Active List are for downside over the next few days. Meanwhile, the black Differential Line falling below 0 means the SPX has outperformed expectations over the last few days. So net expectations are bearish and the SPX is overbought versus recent expectations. Historically, this setup has provided a downside edge. It can be seen on the chart whenever both lines close below zero. This caused the Aggregator System to flip from long to short at the close. This was indicated in the intraday update to subscribers around 3:40 and on the Systems page shortly before the bell.

Tonight's bearish study will be expiring tomorrow and we will see strong positive seasonality once again kicking in. Without new bearish evidence this would turn expectations back to positive. Of course new bearish evidence could emerge and keep expectations negative. The Differential Pivot will be 1,227.13 on Wednesday. This is 1.1% below Tuesday's close. It will take a close lower of at least this much for the Differential Line to close back above 0 on Wednesday.

So there appears to be a downside edge, but it is unlikely to remain beyond Wednesday. As per the intraday update sent to gold subscribers on Tuesday, I exited my long position at the close. Normally with a bearish configuration I'd be looking to get a least some short exposure. The 1-day window is just too tight for the subscriber letter, though. If I were to execute a trade I would be looking for a gap higher to sell into and then I would look to exit the trade by the close in all likelihood.

Master the Gap is my favorite daytrading-based site. In looking at [Scott Andrews work this evening](#) I found that he showed gaps higher under similar circumstances have dipped below the previous day's close 13 of the last 14 times. His gap guides also appear to suggest decent odds of a gap higher pulling back tomorrow.

So traders that are nimble enough may want to try a daytrade Wednesday if the opportunity presents itself. I am not inclined to do so in the letter but may do this personally and then manage it as the day unfolds. And if the SPX does fall tomorrow traders should keep an eye on the Differential Pivot level. A close below there could very easily trigger yet another long signal.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 12/19 – somewhat bullish***

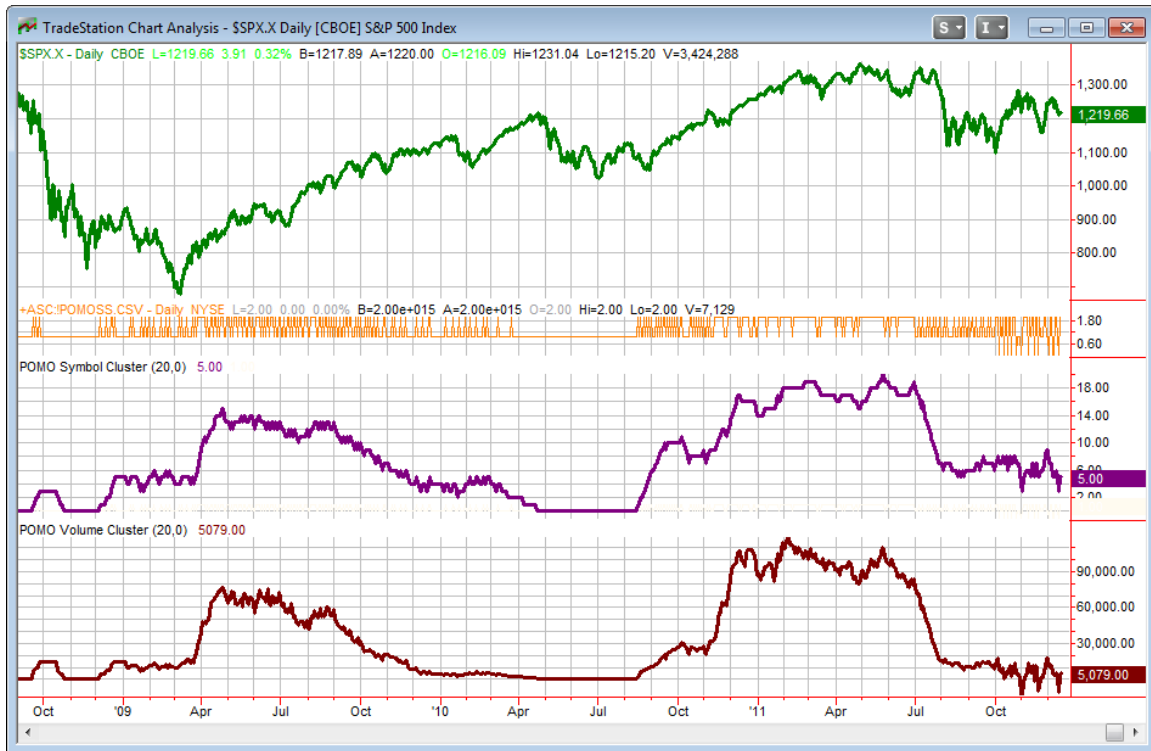
For only the 2<sup>nd</sup> time in the last 28 years the SPX failed to post a close during December op-ex week that was above the close of the previous week. Minimal damage was done, but it was still a little disconcerting to see the market fail to deliver during such a seasonally strong period. As I mentioned in the short-term outlook above, the next seasonally strong period is about to begin on Wednesday's close.

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 \$4.8 billion to the system with purchases a bit stronger than sales. The net volume over the last 20 days is now \$5.1 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.*

*[None tonight.](#)*

## **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	\$6.47	31.77%	\$5.29	looking to hold a while
<b>IWM(1/4)</b>	<b>12/15/2011</b>	<b>\$71.04</b>	<b>\$73.86</b>	<b>3.97%</b>		<b><i>sold on close</i></b>

*IWM was sold at the close with the Aggregator flipping all the way to bearish.*

*XIV popped strongly higher on Tuesday. I am still not inclined to exit this one. With the strong contango and bullish intermediate-term outlook I prefer not to get bucked off by a quick dip. While we may have a down day or two, I intend to ride it out for further gains.*

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