

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 25, 2009

Volume 2 Issue 37

Market Overview

Summary of Recent Active Studies (see <http://QuantifiableEdges.blogspot.com> or Letters from listed dates for details)

Study Date	Description	Time span	Bias	Avg Max Move	Avg MM + 1 Std Dev
Active					
February 25, 2009	Recover drop of 1.5% at 50 low	1-5 days	Bullish	3.40%	6.40%
February 25, 2009	90% Up Vol After 50-low	1-2 days	Bearish	-2.90%	-6.00%
February 25, 2009	VXO 15% Drop @ SP 50-low	1-2 days	Bearish	-2.40%	-5.10%
February 23, 2009	CBI = 7	1-5 days	Bullish	1.80%	4.20%
February 23, 2009	5 Lower Closes at 50 Low	1-4 days	Bullish	2.10%	3.90%
February 20, 2009	McClellan < -200	1-6 days	Bullish	3.85%	6.92%
Active - Long Term					
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish		
Dropped Tonight					
February 24, 2009	5 Days Below Lower Bollinger	1 day	Bullish	1.50%	3.50%
February 18, 2009	2.5% drop after 5-day low	1-5 days	Bullish	4.20%	7.90%
February 23, 2009	Gap dn 1% Close 0.5%>open but dn	1-2 days	Bullish	3.10%	6.50%

If the avg max move is achieved it will appear in **bold and brown**. If the avg + 1 std deviation is achieved, the study will in **bold italic blue**.

Short-term Outlook (1-5 days) – updated 2/25 – bullish

The bounce finally arrived Tuesday and as expected it was quite strong. The Nasdaq and S&P 500 both rose close to 4% on the day. Breadth was extremely positive. On the NYSE the Up Issues % was 84% and the Up Volume % a whopping 93%. Overall volume rose quite a bit above Monday's levels.

In looking at some of the extreme action seen on Tuesday and what transpired after similar circumstances in the past I found some mixed results. First let's go over some of the bad news.

While the market was shooting higher the VXO (original VIX calculation) was dropping sharply. The VXO fell over 15% on Tuesday – a fairly rare occurrence. In the past such drops have shown a mild negative expectancy for the S&P over the next 2 weeks.

VXO drops 15%.										
Buy SPX on close. Sell X days later. \$100k/trade. 1988-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
12	\$17,881.54	39	25	14	64.10	\$2,032.27	(\$2,351.79)	0.86	1.54	\$458.50
11	(\$4,361.98)	40	24	16	60.00	\$1,799.87	(\$2,972.44)	0.61	0.91	(\$109.05)
10	(\$6,394.90)	41	23	18	56.10	\$2,003.16	(\$2,914.86)	0.69	0.88	(\$155.97)
9	(\$7,767.15)	41	20	21	48.78	\$2,021.77	(\$2,295.36)	0.88	0.84	(\$189.44)
8	(\$13,053.44)	41	20	21	48.78	\$1,782.83	(\$2,319.52)	0.77	0.73	(\$318.38)
7	(\$18,407.95)	41	18	23	43.90	\$1,954.49	(\$2,329.94)	0.84	0.66	(\$448.97)
6	(\$12,981.23)	42	20	22	47.62	\$1,765.34	(\$2,194.91)	0.80	0.73	(\$309.08)
5	(\$7,507.60)	43	22	21	51.16	\$2,375.24	(\$2,845.85)	0.83	0.87	(\$174.60)
4	(\$14,704.53)	45	26	19	57.78	\$1,486.40	(\$2,807.94)	0.53	0.72	(\$326.77)
3	(\$22,440.43)	45	18	27	40.00	\$1,692.68	(\$1,959.58)	0.86	0.58	(\$498.68)
2	(\$25,992.19)	45	20	25	44.44	\$1,261.67	(\$2,049.03)	0.62	0.49	(\$577.60)
1	(\$8,246.08)	46	17	29	36.96	\$1,200.68	(\$988.19)	1.22	0.71	(\$179.26)

You can see the bearish tendencies are fairly mild and dissipate after day 2. But what if the 15% VXO drops immediately follows a 50-day low in the S&P 500? Here the results look quite a bit worse:

VXO drops 15% 1 day after the S&P makes a 50-day low.										
Buy SPX on close. Sell X days later. \$100k/trade. 1986-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
10	(\$18,256.65)	9	3	6	33.33	\$2,140.95	(\$4,113.25)	0.52	0.26	(\$2,028.52)
9	(\$17,537.29)	9	2	7	22.22	\$2,847.60	(\$3,318.93)	0.86	0.25	(\$1,948.59)
8	(\$15,445.06)	9	3	6	33.33	\$1,420.04	(\$3,284.20)	0.43	0.22	(\$1,716.12)
7	(\$18,465.32)	9	3	6	33.33	\$1,138.81	(\$3,646.96)	0.31	0.16	(\$2,051.70)
6	(\$10,802.57)	9	2	7	22.22	\$1,778.38	(\$2,051.33)	0.87	0.25	(\$1,200.29)
5	\$1,950.13	9	3	6	33.33	\$3,383.88	(\$1,366.92)	2.48	1.24	\$216.68
4	(\$2,836.34)	10	5	5	50.00	\$1,730.12	(\$2,297.39)	0.75	0.75	(\$283.63)
3	(\$10,706.98)	10	2	8	20.00	\$1,760.84	(\$1,778.58)	0.99	0.25	(\$1,070.70)
2	(\$11,323.16)	10	5	5	50.00	\$937.96	(\$3,202.59)	0.29	0.29	(\$1,132.32)
1	(\$3,686.04)	10	1	9	10.00	\$614.72	(\$477.86)	1.29	0.14	(\$368.60)

Notable above is that only 1 of 10 instances saw the S&P rise the next day. Not shown in the chart is that the lone day 1 winner closed lower than the entry on day 3 – meaning there was a short-term pullback in every case. Instances are a bit low in this study but notable and strongly suggestive nonetheless.

The 93% Up Volume day showed that breadth was extremely strong. 90% days near market lows have been used by Lowry's and others to help identify market bottoms. Unfortunately a 90% day immediately follow a 50-day low has not had bullish implications for the short-term:

NYSE Up Volume % Exceeds 90% 1 Day After S&P 500 Makes A 50-day Low.										
Buy SPX on close. Sell X days later. \$100k/trade. 1970-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	(\$24,950.03)	6	1	5	16.67	\$1,102.63	(\$5,210.53)	0.21	0.04	(\$4,158.34)
9	(\$23,653.61)	6	1	5	16.67	\$472.15	(\$4,825.15)	0.10	0.02	(\$3,942.27)
8	(\$20,293.38)	6	0	6	0.00	\$0.00	(\$3,382.23)	0.00	0.00	(\$3,382.23)
7	(\$18,298.49)	7	1	6	14.29	\$1,524.21	(\$3,303.78)	0.46	0.08	(\$2,614.07)
6	(\$9,154.71)	7	2	5	28.57	\$1,743.78	(\$2,528.45)	0.69	0.28	(\$1,307.82)
5	\$1,271.57	7	2	5	28.57	\$4,851.87	(\$1,686.43)	2.88	1.15	\$181.65
4	(\$6,628.83)	7	4	3	57.14	\$1,470.74	(\$4,170.59)	0.35	0.47	(\$946.98)
3	(\$3,630.59)	7	3	4	42.86	\$1,825.02	(\$2,276.42)	0.80	0.60	(\$518.66)
2	(\$10,541.19)	7	3	4	42.86	\$825.71	(\$3,254.58)	0.25	0.19	(\$1,505.88)
1	(\$6,291.95)	7	0	7	0.00	\$0.00	(\$898.85)	0.00	0.00	(\$898.85)

Again instances are low here but there are certainly some notable numbers. Zero for seven rising the next day for one. An average loss of 4% over the next 2 weeks is quite sizable as well – although it was greatly skewed by a single loss of 15%. Below I’ve listed the 7 instances along with their 1-day losses:

Date/Time	Signal	Price	Roll Over USD/Lot	Shares/Ctrts	Net Profit	% Profit
				Profit	Cum Net Profit	
11/01/78	Buy	\$96.85	\$0.00	1032	(\$1,279.68)	(1.28%)
11/02/78	Sell	\$95.61			(\$1,279.68)	
04/05/94	Buy	\$448.29	\$0.00	223	(\$53.52)	(0.05%)
04/06/94	Sell	\$448.05			(\$1,333.20)	
03/06/07	Buy	\$1,395.41	\$0.00	71	(\$244.24)	(0.25%)
03/07/07	Sell	\$1,391.97			(\$1,577.44)	
11/13/07	Buy	\$1,481.01	\$0.00	67	(\$769.83)	(0.78%)
11/14/07	Sell	\$1,469.52			(\$2,347.27)	
11/23/07	Buy	\$1,440.70	\$0.00	69	(\$2,311.50)	(2.33%)
11/26/07	Sell	\$1,407.20			(\$4,658.77)	
10/13/08	Buy	\$1,003.35	\$0.00	99	(\$528.66)	(0.53%)
10/14/08	Sell	\$998.01			(\$5,187.43)	
10/28/08	Buy	\$940.51	\$0.00	106	(\$1,104.52)	(1.11%)
10/29/08	Sell	\$930.09			(\$6,291.95)	
02/24/09	Buy	\$773.14		129	n/a	n/a
open	n/a	\$773.14		n/a	n/a	

As I mentioned above, not all news was bad. I look at all instances where sharp drops that made 50-day lows were followed by sharp rebounds that erased the previous day’s drop. First let’s look at 5-day returns based on the size of the drop/rebound:

Yesterday S&P 500 drops at least X% and closes at 50-day low. Today S&P makes up for all of yesterday's loss and more.										
Buy SPX on close. Sell 5 days later. \$100k/trade. 1960-present.										
X% Drop	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
-1	\$36,311.93	28	18	10	64.29	\$3,604.14	(\$2,856.26)	1.26	2.27	\$1,296.85
-1.25	\$27,265.01	22	14	8	63.64	\$3,859.20	(\$3,345.47)	1.15	2.02	\$1,239.32
-1.5	\$24,308.63	15	10	5	66.67	\$4,072.91	(\$3,284.10)	1.24	2.48	\$1,620.58
-1.75	\$23,086.76	11	8	3	72.73	\$4,648.29	(\$4,699.86)	0.99	2.64	\$2,098.80
-2	\$16,169.16	9	6	3	66.67	\$5,044.79	(\$4,699.86)	1.07	2.15	\$1,796.57
-2.25	\$24,398.97	7	6	1	85.71	\$5,044.79	(\$5,869.76)	0.86	5.16	\$3,485.57
-2.5	\$24,398.97	7	6	1	85.71	\$5,044.79	(\$5,869.76)	0.86	5.16	\$3,485.57
-2.75	\$8,876.46	2	2	0	100.00	\$4,438.23	\$0.00	100.00	100.00	\$4,438.23
-3	\$6,915.44	1	1	0	100.00	\$6,915.44	\$0.00	100.00	100.00	\$6,915.44

Here it appears the larger the drop and rebound the better although instances are quite low when you get down below 1-1.5%. Now let's look at the 1.5% drops and see how they performed X days out:

Yesterday S&P 500 drops at least 1.5% and closes at 50-day low. Today S&P makes up for all of yesterday's loss and more.											
Buy SPX on close. Sell X days later. \$100k/trade. 1960-present.											
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade	
15	\$40,610.78	15	12	3	80.00	\$4,740.40	(\$5,424.67)	0.87	3.50	\$2,707.39	
14	\$39,535.38	15	12	3	80.00	\$4,634.62	(\$5,360.02)	0.86	3.46	\$2,635.69	
13	\$36,912.27	15	11	4	73.33	\$4,532.48	(\$3,236.26)	1.40	3.85	\$2,460.82	
12	\$37,183.99	15	10	5	66.67	\$4,686.30	(\$1,935.81)	2.42	4.84	\$2,478.93	
11	\$28,664.80	15	9	6	60.00	\$4,964.75	(\$2,669.66)	1.86	2.79	\$1,910.99	
10	\$25,550.44	15	10	5	66.67	\$3,865.06	(\$2,620.03)	1.48	2.95	\$1,703.36	
9	\$25,348.79	15	9	6	60.00	\$4,577.12	(\$2,640.88)	1.73	2.60	\$1,689.92	
8	\$18,732.41	15	8	7	53.33	\$4,570.71	(\$2,547.60)	1.79	2.05	\$1,248.83	
7	\$15,881.33	15	9	6	60.00	\$4,100.52	(\$3,503.89)	1.17	1.76	\$1,058.76	
6	\$14,071.39	15	9	6	60.00	\$3,783.76	(\$3,330.41)	1.14	1.70	\$938.09	
5	\$24,308.63	15	10	5	66.67	\$4,072.91	(\$3,284.10)	1.24	2.48	\$1,620.58	
4	\$16,571.18	15	10	5	66.67	\$3,125.93	(\$2,937.62)	1.06	2.13	\$1,104.75	
3	\$17,342.89	15	9	6	60.00	\$3,149.76	(\$1,834.17)	1.72	2.58	\$1,156.19	
2	\$6,459.53	15	8	7	53.33	\$1,701.21	(\$1,021.45)	1.67	1.90	\$430.64	
1	\$566.56	15	6	9	40.00	\$1,359.48	(\$843.37)	1.61	1.07	\$37.77	

Here we see not only a good first week but the returns over the next 3 weeks are also strong. An average trade of 2.7% with 80% winners 15 days out is a positive sign.

We should also keep in mind that even with Tuesday's bounce, the oversold conditions that built up over the last week haven't yet relieved themselves. The CBI, for instance, still remains at 8. I generally don't consider it neutral until it returns to 3 or at a bare minimum is being carried by only two stocks. None have yet triggered exits.

Tonight's [Aggregator](#) chart is below:



Even with the two short-term bearish studies included the Aggregator remains solidly positive. And the sharp rise on Tuesday still couldn't put the black differential line below 0. This means the market is still in a period of underperforming expectations over the last 3 days while expectations remain positive. This suggests to me that the rally attempt may have a bit further to go.

In the very short-term the studies were fairly convincing that we may see a 1-2 day struggle. There are currently 3 lots of SPY on the active trade idea list. Unfortunately this morning's gap didn't quite get back to the limit price and we missed entry on the 4th and final piece by \$0.09. Hopefully some of you decided that was close enough or at least took some Monday afternoon after I sent out the intraday update hinting at a strong possibility of a bounce Tuesday. Since there is a fairly strong suggestion that the market is likely to pull back in the next day or so I'm going to look to exit 1 lot of the SPY on strength tomorrow. I will let the other two ride and continue to evaluate as this bounce plays out. Details below the active trade ideas table below.

Intermediate-term Outlook (2 weeks – 2 months)–neutral -updated 2/23

The S&P 500 lost nearly 7% this past week and is down just shy of 15% so far for 2009. The Dow has fallen through its November lows and they aren't far behind for the S&P. The Nasdaq – with hardly any exposure to the financial sector is still above its January lows and far above the November bottom.

With the November S&P bottom fast approaching one thing we haven't seen yet is a sharp spike in the VIX. Some may find this concerning. I've looked at this a few times in the past and failed to find evidence that a VIX spike is a necessary component for

making a bottom. One such study was posted to the blog on [July 1, 2008](#). Tonight I decided to compare a 50-day low that is accompanied by a VIX spike to a 50-day low that isn't.

First let's look at instances where the 50-day low is accompanied by a VIX spike:

SPX closes at a 50-day low. VIX stretched more than 10% above its 10-day ma.										
Buy on close. Sell X days later. \$100k/trade. 1990-2/20/2009.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
12	\$39,220.05	50	29	21	58.00	\$3,476.42	(\$2,933.14)	1.19	1.64	\$784.40
11	\$42,178.74	50	29	21	58.00	\$3,166.90	(\$2,364.83)	1.34	1.85	\$843.57
10	\$22,479.00	50	26	24	52.00	\$3,380.46	(\$2,725.54)	1.24	1.34	\$449.58
9	\$25,834.31	55	32	23	58.18	\$3,370.74	(\$3,566.50)	0.95	1.31	\$469.71
8	\$36,021.98	58	35	23	60.34	\$3,167.85	(\$3,254.47)	0.97	1.48	\$621.07
7	\$34,637.59	60	34	26	56.67	\$3,151.44	(\$2,788.90)	1.13	1.48	\$577.29
6	\$40,678.40	62	37	25	59.68	\$2,821.36	(\$2,548.47)	1.11	1.64	\$656.10
5	\$49,714.63	66	38	28	57.58	\$2,569.25	(\$1,711.31)	1.50	2.04	\$753.25
4	\$17,536.97	71	44	27	61.97	\$1,965.76	(\$2,553.94)	0.77	1.25	\$247.00
3	\$30,767.71	80	52	28	65.00	\$1,823.81	(\$2,288.22)	0.80	1.48	\$384.60
2	\$41,125.51	94	56	38	59.57	\$2,091.91	(\$2,000.56)	1.05	1.54	\$437.51
1	\$40,629.20	135	74	61	54.81	\$1,760.50	(\$1,469.63)	1.20	1.45	\$300.96

Now let's look at a 50-day low with a VIX spike:

SPX closes at a 50-day low. VIX not stretched more than 10% above its 10-day ma.										
Buy on close. Sell X days later. \$100k/trade. 1990-2/20/2009.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
12	\$18,727.57	36	23	13	63.89	\$3,140.27	(\$4,115.28)	0.76	1.35	\$520.21
11	\$41,069.19	37	24	13	64.86	\$3,389.58	(\$3,098.52)	1.09	2.02	\$1,109.98
10	\$38,325.09	39	27	12	69.23	\$2,925.21	(\$3,387.98)	0.86	1.94	\$982.69
9	\$56,900.65	40	27	13	67.50	\$3,392.41	(\$2,668.80)	1.27	2.64	\$1,422.52
8	\$41,206.16	40	26	14	65.00	\$3,110.93	(\$2,834.15)	1.10	2.04	\$1,030.15
7	\$43,021.13	42	28	14	66.67	\$2,791.73	(\$2,510.52)	1.11	2.22	\$1,024.31
6	\$26,299.24	42	26	16	61.90	\$2,619.28	(\$2,612.63)	1.00	1.63	\$626.17
5	\$23,026.84	47	24	23	51.06	\$2,942.60	(\$2,069.38)	1.42	1.48	\$489.93
4	\$16,421.58	49	30	19	61.22	\$2,087.02	(\$2,431.00)	0.86	1.36	\$335.13
3	\$28,712.59	51	35	16	68.63	\$1,986.15	(\$2,550.18)	0.78	1.70	\$562.99
2	\$17,981.18	62	31	31	50.00	\$1,982.54	(\$1,402.50)	1.41	1.41	\$290.02
1	\$17,533.60	76	49	27	64.47	\$1,007.94	(\$1,179.82)	0.85	1.55	\$230.71

It's more common to see a spike in the VIX than not. Comparison between the two sets of results, though, shows very little difference. This suggests the VIX is not an effective filter when considering whether a drop in the market is likely to mark a low. While I'm sure a very sharp spike would produce some bullish studies and help provide some possible juice for a rebound, it's not something I'm going to worry over a great deal.

From an intermediate-term standpoint it appears too late to get strongly bearish but without some real signs of strength too early to get strongly bullish. My summary from last week still works for me so I'll repeat it below.

As I've been saying, I expect we're likely to see a decent rally of 30% or more lasting at least 2-3 months emerge here at some point. I have serious doubts that next rally will lead to a multi-year bull market run, though. Until I see signs otherwise, I'm treating

this market as one that is more similar to the 1930's than any other period in time. Past evidence of this includes volatility studies, Dow Trend vs. Chop studies, and studies of severe selloffs such as we saw in the fall. I'll be sure to revisit these studies when appropriate. For now my focus remains short-term.

Catapult and Capitulative Breadth Statistics

(Catapult Presentation Part 1) (Catapult Presentation Part 2)

Open Catapult Triggers

DOW (Dow Chemical) –@ \$9.29 (1/3)
 DOW (Dow Chemical) –@ \$8.62 (1/3)
 DOW (Dow Chemical) – bought last 1/3 position @ \$8.60
 CAT – bought 1/3 position @ \$28.44
 CAT – bought 1/3 position @ \$26.14
 CAT – bought final 1/3 position @ \$26.66
 C – (not recommended) @ \$1.95
 PFE – bought 1/3 position @ \$13.27 limit

Catapult for ETF's Trades

DIA – bought @ \$73.73 limit

Broad Market Large Cap CBI – 8/4 (DOW-3, CAT-3, C, PFE)

Sector CBI Breakdown (% of stocks with active catapult triggers within each sector.)

Index	ETF	CBI %	Index	ETF	CBI %
DJ US Broker Dealers	IAI	3.45	DJ US Energy	IYE	2.33
DJ US Insurance Index	IAK	9.46	DJ US Financial	IYF	7.19
DJ US Regional Banks	IAT	16.25	DJ US Financial Services	IYG	9.79
DJ US Utilities	IDU	2.70	DJ US Healthcare	IYH	6.34
DJ US Oil&Gas Expl & Prod	IEO	6.90	DJ US Industrial Sector	IYJ	5.36
DJ US Oil Equip & Svcs	IEZ	5.77	DJ US Consumer Goods	IYK	5.44
DJ US Pharmaceuticals	IHE	10.81	DJ US Basic Materials	IYM	9.46
DJ US Healthcare Providers	IHF	2.04	DJ US Real Estate	IYR	2.44
DJ US Medical Devices	IHI	2.44	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	2.78	DJ US Technology Sector	IYW	4.52
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	3.07	Nasdaq 100	QQQQ	3.00

Few numbers have begun to decline yet...

Additional New Trade Ideas

None tonight.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
DOW(1/3)	2/17/2009	\$9.29	\$7.93	-14.64%		Catapult
DOW(1/3)	2/18/2009	\$8.62	\$7.93	-8.00%		Catapult
SPY(1/4)	2/18/2009	\$79.22	\$77.35	-2.36%		
DOW(1/3)	2/19/2009	\$8.60	\$7.93	-7.79%		Catapult
CAT(1/3)	2/19/2009	\$28.44	\$26.04	-8.44%		Catapult
SPY(1/4)	2/19/2009	\$78.18	\$77.35	-1.06%		
SPY(1/4)	2/20/2009	\$77.42	\$77.35	-0.09%		
CAT(1/3)	2/20/2009	\$26.14	\$26.04	-0.38%		Catapult
KBE	2/20/2009	\$10.86	\$12.21	12.43%		<i>Sold @ close</i>
CAT(1/3)	2/23/2009	\$26.66	\$26.04	-2.33%		Catapult
DIA	2/23/2009	\$73.73	\$73.25	-0.65%		Catapult
PFE	2/24/2009	\$13.27	\$13.59	2.41%		Catapult

KBE was exited at the close as mentioned it would be in the intraday update.

I'll look to exit 1 lot of SPY at a \$77.50 limit for reasons discussed in the short-term outlook above.

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