

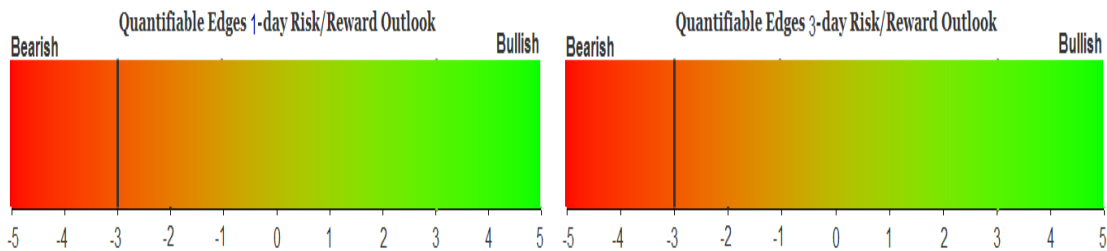
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 19, 2011

Volume 4 Issue 12

Market Overview



Tonight's Research Points

- The SPX hitting a new high on high volume suggests bullish short and intermediate-term implications.
- New SPY highs on declining volume suggest mildly bearish short-term implications.
- The VIX rising along with the SPX just after the weekend is potentially short-term bearish.
- The Aggregator System is short.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook

The Bottom Line

Bearish studies continue to rule. And with the market overbought I believe there is a downside edge. I'm looking to take advantage of that downside edge with a small short position.

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
Active				
January 19, 2011	SPX 20-day high. Vol 20-day high.	1-9 days	Bullish	2.40%
January 19, 2011	SPX up VIX up	1-2 days	Bearish	
January 19, 2011	SPY 2 50 day highs on lower volume	1-2 days	Bearish	
January 18, 2011	SPY new high, inside day, new high	1-5 days	Bearish	-2.30%
January 18, 2011	Op-ex, MLK week	1-4 days	Bearish	-3.00%
Active - Long Term				
January 19, 2011	SPX 20-day high. Vol 20-day high.	int term	Bullish	
January 10, 2011	Nas/SPX RS Indicator favors Nas	int term	Bullish	
January 4, 2011	SPX up 1st day of year	1-13 days	Bearish	
January 3, 2011	SPX down last 2 days of up quarter	1-15 days	Bullish	
December 30, 2010	SPX closes > 10ma every day of month	1 month	Bullish	
December 16, 2010	2 Hindenburg Signals	1-50 days	Bearish	
December 9, 2010	SPX & TNX 50-day highs	1-50 days	Bearish	
November 22, 2010	High number of POMO Days recently	int term	Bullish	
October 25, 2010	SPX Golden Cross	int term	Bullish	
Dropped Tonight				
January 18, 2011	SPX 50 high. VIX:VXV < 0.85	1 day	Bearish	

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

The Evidence

News from AAPL put the NASDAQ off to a rough start, but it recovered nicely and finished up on the day. The other indices saw much less eventful action. In the end the SPX was up 0.1%, the NASDAQ rose 0.4%, and the Russell 2000 tacked on less than 0.1%. Breadth was mixed. The NYSE Up Issues % was mildly positive at 54% while the Up Volume % came in down at 42%. Total NYSE volume rose to the highest level of the last 20 days.

The Quantifinder identified several studies tonight. They were mixed between bullish and bearish. I'll discuss a number of them and show those that I feel are worth inclusion in the Aggregator.

In the 11/8/10 Subscriber Letter I looked at times the SPX closed above its Bollinger Bands and at a new 50-day high two days in a row. The study appeared to have mildly bullish implications. I also examined somewhat stricter criteria in that letter which required the %b to close above 115 both days. Tonight I took a closer look at instances like the present where the Bollinger Bands have been pierced, but not by enough to put

the percent %b above 115. I found that by filtering out these very high %b instances the upside edge was no longer apparent.

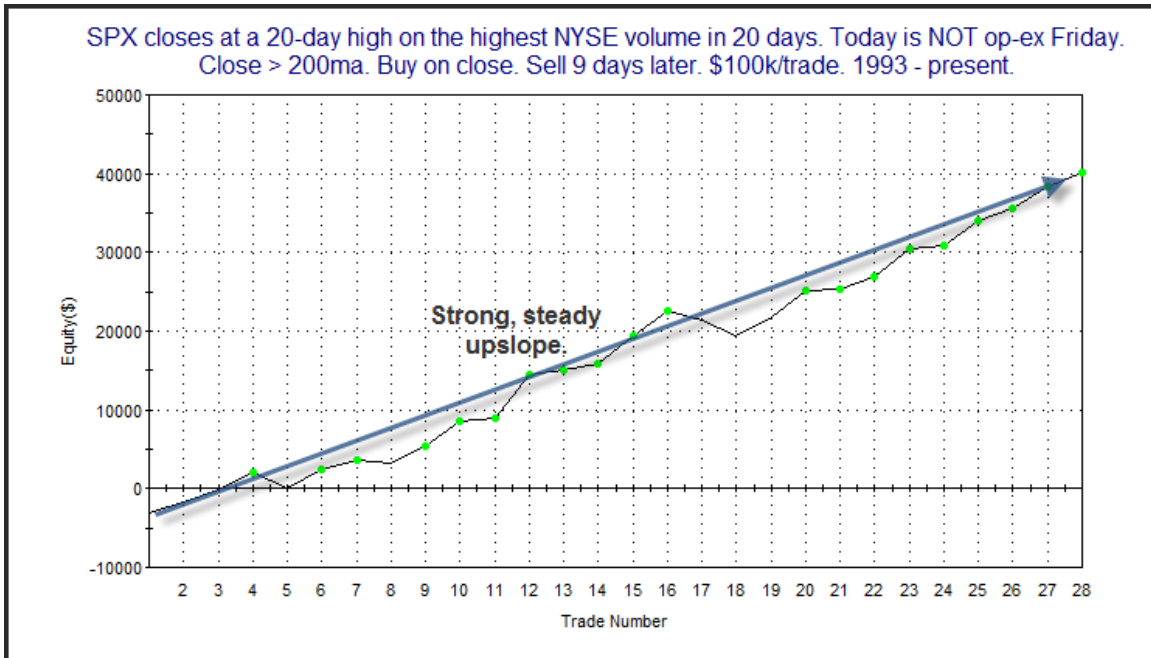
Another bullish study from the Quantifinder showed more promise. It looked at days the SPX rose while volume was spiking to a new 20 day high. In the 12/21/09 letter I examined this and filtered out op-ex Fridays. The bottom line with those studies was that high volume up days on op-ex Friday carried bearish implications, but on other days it appeared bullish. Tonight rather than simply requiring the SPX to close higher, I elected to also require a 20 day closing high.

SPX closes at a 20-day high on the highest NYSE volume in 20 days. Today is NOT op-ex Friday. Close > 200ma. 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: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
20	58,293.37	27	22	5	81.48	3,082.35	-1,903.67	1.62	7.12	2,159.01
19	60,603.89	27	22	5	81.48	3,202.90	-1,971.99	1.62	7.15	2,244.59
18	57,552.74	27	22	5	81.48	3,056.81	-1,939.40	1.58	6.94	2,131.58
17	59,040.79	27	23	4	85.19	3,036.43	-2,699.26	1.12	6.47	2,186.70
16	60,100.99	27	22	5	81.48	3,090.45	-1,577.78	1.96	8.62	2,225.96
15	58,106.20	28	20	8	71.43	3,347.73	-1,106.05	3.03	7.57	2,075.22
14	54,153.51	28	23	5	82.14	2,698.62	-1,582.96	1.70	7.84	1,934.05
13	53,319.62	28	23	5	82.14	2,623.35	-1,403.48	1.87	8.60	1,904.27
12	45,091.72	28	22	6	78.57	2,422.91	-1,368.73	1.77	6.49	1,610.42
11	44,129.10	28	23	5	82.14	2,311.91	-1,808.96	1.28	5.88	1,576.04
10	35,908.75	28	20	8	71.43	2,379.87	-1,461.09	1.63	4.07	1,282.46
9	40,153.45	28	23	5	82.14	2,124.92	-1,743.94	1.22	5.60	1,434.05
8	36,176.53	28	21	7	75.00	2,149.81	-1,281.34	1.68	5.03	1,292.02
7	32,062.84	29	22	7	75.86	1,784.04	-1,026.58	1.74	5.46	1,105.62
6	27,759.53	29	22	7	75.86	1,785.12	-1,644.72	1.09	3.41	957.23
5	23,975.03	29	21	8	72.41	1,664.33	-1,372.00	1.21	3.18	826.73
4	24,085.36	30	21	9	70.00	1,554.11	-950.11	1.64	3.82	802.85
3	21,276.18	32	23	9	71.88	1,248.68	-827.04	1.51	3.86	664.88
2	10,872.01	33	22	11	66.67	795.58	-602.80	1.32	2.64	329.45
1	9,691.46	43	26	17	60.47	620.71	-379.24	1.64	2.50	225.38

88% of instances posted a close above the entry price at some point in the next week.

These results appear to be very solid for both the short and intermediate term. To get a better feel for the distribution of returns I produced an equity curve using a 9-day exit strategy.



As you can see the upslope appears very steady. This seems to be a study worth considering.

But while total NYSE volume came in high, SPY volume did not. This is something I examined in the 11/8/10 Subscriber Letter. Below is an excerpt from that letter.

While NYSE volume has been strong the last 2 days, SPY volume has been unremarkable and has actually declined. This brought about the following study... (table updated)

SPY closes at a 50-day high for the 2nd day in a row. Volume declines both 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: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-9,488.12	50	23	26	46.00	997.63	-1,247.45	0.80	0.71	-189.76
4	-10,020.41	51	23	28	45.10	853.03	-1,058.57	0.81	0.66	-196.48
3	-9,330.51	51	23	28	45.10	845.90	-1,028.08	0.82	0.68	-182.95
2	-7,919.58	51	22	29	43.14	653.24	-768.65	0.85	0.64	-155.29
1	-2,939.50	55	17	37	30.91	661.18	-383.23	1.73	0.79	-53.45

This suggests a decent chance at a mild pullback over the next few days. A concern I had when considering this study tonight is whether the fact that the NYSE volume not

confirming invalidates or weakens the results. So I checked other times this occurred when the NYSE volume didn't confirm. (Table not updated)

SPY closes at a 50-day high for the 2nd day in a row. Volume declines both days. NYSE volume doesn't confirm. 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: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-3,013.53	31	16	14	51.61	1,132.61	-1,509.67	0.75	0.86	-97.21
4	-4,213.76	31	15	16	48.39	1,038.85	-1,237.28	0.84	0.79	-135.93
3	-5,551.79	31	12	19	38.71	1,094.38	-983.38	1.11	0.70	-179.09
2	-7,282.21	31	14	17	45.16	583.08	-908.55	0.64	0.53	-234.91
1	-1,837.23	33	8	24	24.24	867.91	-365.85	2.37	0.79	-55.67

87% of instances posted a close below the entry price at some point in the next 3 days.

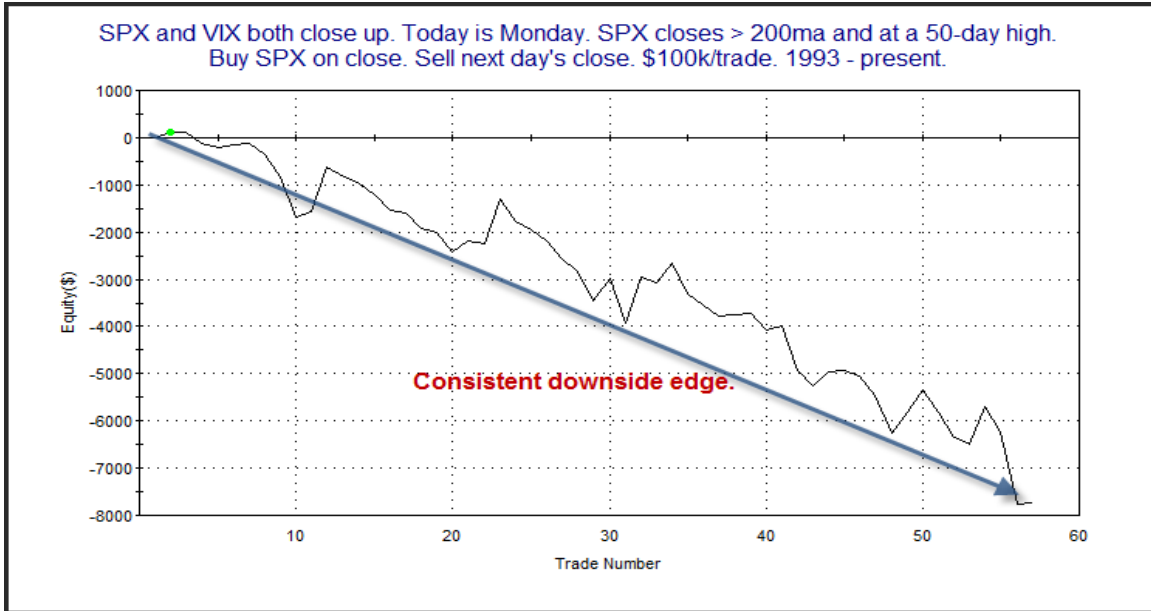
It appears my concern here was unfounded. Without NYSE confirmation the results are quite similar.

There is more than just declining SPY volume that is suggesting a mild downside edge. Today's VIX action also brought about some interesting studies. Most of my VIX studies take day-of-week into consideration. This is because there is a natural inclination for the VIX to fall on Fridays and rise on Mondays due to weekend option time decay. So since it was Tuesday, the VIX studies that appeared all examined mid-week instances. But since this is the first day after the long holiday weekend I felt that Monday numbers would be more appropriate to examine. Therefore I have taken one of the more compelling mid-week studies to see how it looks on Mondays.

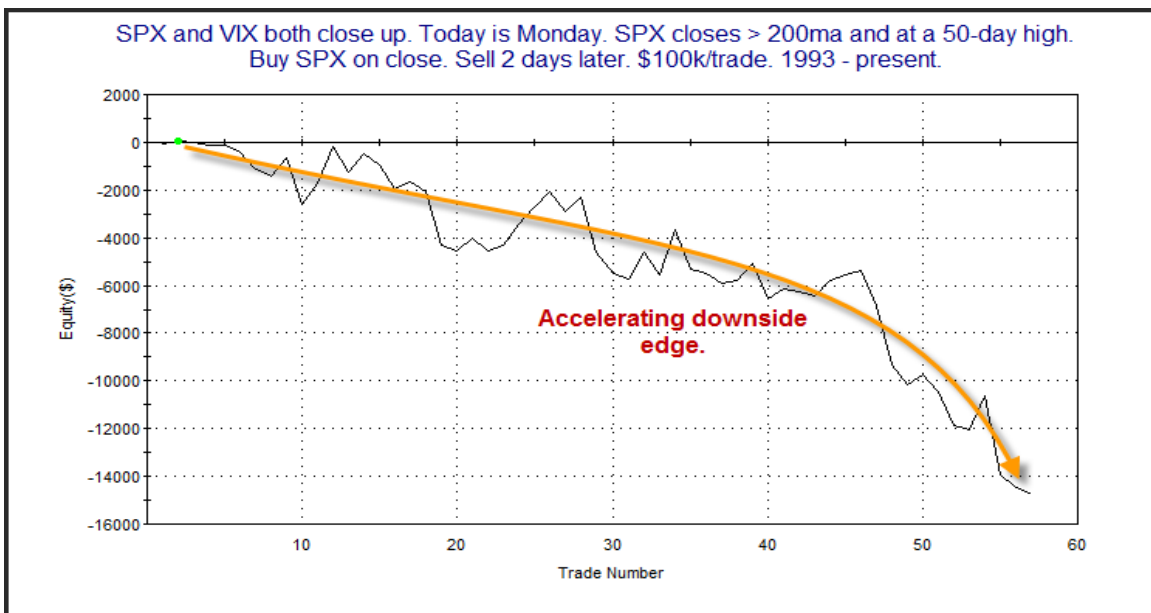
SPX and VIX both close up. Today is Monday. SPX closes > 200ma and at a 50-day high. Buy SPX on close. Sell X days later. \$100k/trade. 1993 - present.

X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-7,895.71	56	23	33	41.07	1,381.52	-1,202.14	1.15	0.80	-140.99
4	-10,066.01	57	24	32	42.11	1,142.81	-1,171.67	0.98	0.73	-176.60
3	-2,995.69	57	29	27	50.88	911.93	-1,090.43	0.84	0.90	-52.56
2	-14,743.60	57	23	34	40.35	654.87	-876.64	0.75	0.51	-258.66
1	-7,743.17	57	19	36	33.33	343.32	-396.29	0.87	0.46	-135.85

As you would suspect the edge is not as strong as it would be if I used a mid-week filter rather than a Monday filter. Still, there does appear to be a short-term bearish implication, even on Mondays. The downside edge appears to prevail over the first 1-2 days. Below are equity curves using a 1-day exit and a 2-day exit.



The 1-day exit strategy has led to a consistent downside edge over time. What about the 2-day?



The equity curve for the 2-day exit is also appealing from a bearish perspective. The downside edge here seems to have become more pronounced over time.

This all leaves us with a mix of studies being included on the Active List tonight.

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



Tonight's mix of studies moved the green Aggregator line closer to 0, but left it still squarely in negative territory. The negative value means the net expectation from the Active Studies List is for downside over the next few days. Meanwhile the black Differential line is again below 0. The negative value means the SPX has outperformed expectations over the last few days. So net expectations are for upside and the SPX has outperformed recent expectations. Historically this has suggested a downside edge. It can be seen on the chart whenever both lines are below zero. Due to this the Aggregator System remained short at the close.

The green Aggregator line is tentatively set up to remain below 0 on Wednesday. Of course this could change if bullish evidence emerges. Meanwhile the Differential Pivot

will be 1,287.90. This is over 0.5% below Friday's close. This means it would take a drop of this magnitude for the SPX to be considered "oversold". This would cause the black Differential line to move back above zero.

My short-term bias is still bearish. I remain cautious since I am dealing with a countertrend trade here that is also counter to my intermediate-term outlook.

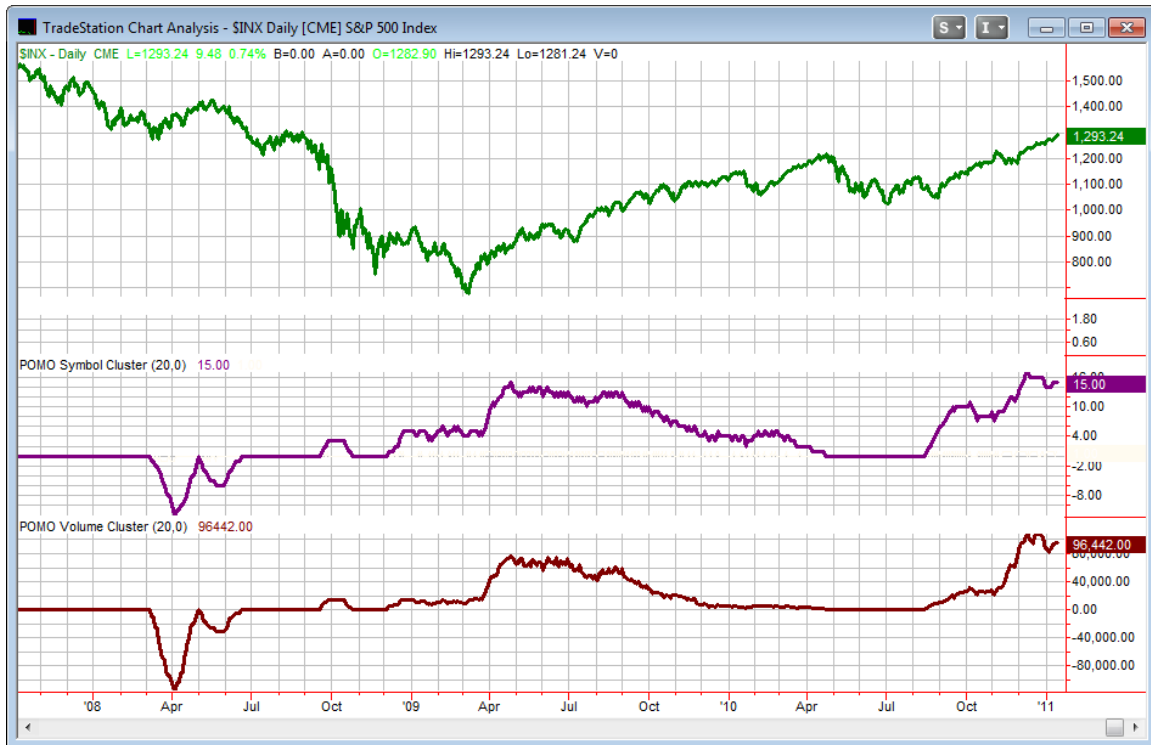
Intermediate-term Outlook (2 weeks – 2 months)– updated 1/18 - slightly bullish

Intermediate-term indications remain mixed. New highs continue to be made each week, and until price weakness is evident I will likely continue to favor the bullish outlook.

I've been updating the POMO chart each week 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 pane is the rolling number of days in the last 20 that have been POMO days. The bottom pane is the total amount of money infused into 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>



POMO activity again remained strong this past week. But that wasn't the most notable news with regards to POMO. On Wednesday the Fed released its tentative operations schedule for the next month. Buying is slated to remain strong and that should continue to act as a positive for some time.

There were no new studies of intermediate-term significance this past week. All of the same intermediate-term studies remain intact from last week. We will start seeing some begin to expire this week though. Potential negative influences remain related to breath, bond action, and seasonality. Momentum, relative strength, and POMO are all pointing to the upside.

So there is still a mix of studies and indicators for the intermediate-term. With the trend favoring the bulls I'm inclined to give them the edge. I will continue to look for trades in both directions but will trade the short side with a bit more caution.

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 @ \$129.53 LIMIT ON CLOSE. Based on the short-term outlook above. I'll scale in a little more if the SPX closes higher tomorrow.

If you are inclined to get more aggressive, there was a good number of short triggers on the triggers spreadsheet tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	1/18/2011	\$129.30	\$129.52	-0.17%		Aggregator

I will look to cover the SPY position on an SPX close of 1,287.90 or lower.

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