

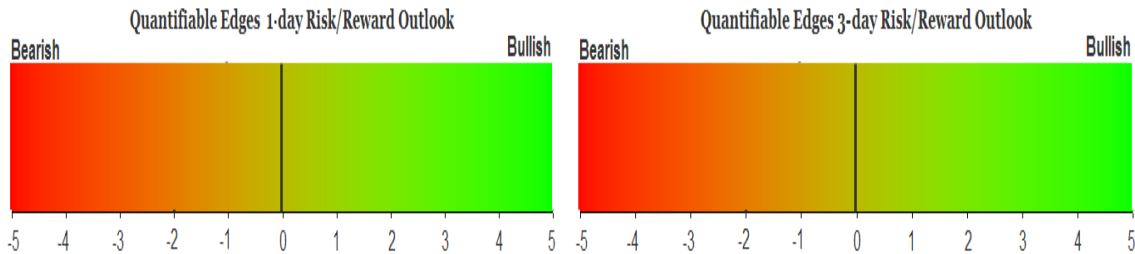
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 20, 2011

Volume 4 Issue 13

Market Overview



Tonight's Research Points

- Sizable drops on very weak breadth only suggest a 1-day bounce when they immediately follow a 50-day high.
- When SPY leaves an unfilled gap down following a 50-day high it is often followed by further selling.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is long.

Short-term Outlook

The Bottom Line

The expected move lower arrived today and quickly flipped the market from short-term overbought to short-term oversold. The studies suggest there may be farther to fall, but since we are now short-term oversold, I've covered my short and am awaiting the next opportunity.

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 20, 2011	1% Drop Decl 2x Adv from 50-high	1 day	Bullish	
January 20, 2011	Unfilled Gap Down from 50-day high	1-2 days	Bearish	-1.10%
January 19, 2011	SPX 20-day high. Vol 20-day high.	1-9 days	Bullish	2.40%
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 19, 2011	SPY 2 50 day highs on lower volume	1-2 days	Bearish	-1.10%
January 19, 2011	SPX up VIX up	1-2 days	Bearish	-1.00%

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

The Evidence

Perhaps ignited by some of the bearish evidence I've noted in the last two days, the market put in its first substantial day of selling since November. The SPX lost 1%, the NASDAQ was down 1.5%, and the Russell 2000 dropped a whopping 2.6%. Breadth came in strongly negative as the NYSE Up Issues % was 22% and the Up Volume % was 11%. Total NYSE volume declined from Thursday's levels.

I've shown many times before that sharp drops on strongly negative breadth often suggest a bounce. I've also demonstrated in the past the importance of considering the position of the market when trying to interpret the meaning of such a drop. Substantial drops coming from a high level do not carry the same edge as other times.

This first study below is similar to a test I've shown many times before. It looks at strong drops that do NOT immediately follow a 50 day high. (In the past I've used a 20 day high, which gives very similar results.)

SPX closes down at least 1% and NYSE decliners more than double
 advancers. Close > 200ma. Yesterday SPX closed < a 50-day high.
 Buy 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: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	144,655.02	136	93	43	68.38	2,495.49	-2,033.15	1.23	2.65	1,063.64
9	162,067.61	140	102	38	72.86	2,315.82	-1,951.20	1.19	3.19	1,157.63
8	138,568.46	146	101	45	69.18	2,204.62	-1,868.84	1.18	2.65	949.10
7	130,388.03	155	102	53	65.81	2,106.85	-1,594.54	1.32	2.54	841.21
6	100,385.62	157	100	57	63.69	1,944.86	-1,650.88	1.18	2.07	639.40
5	80,582.46	163	93	70	57.06	1,892.39	-1,363.00	1.39	1.84	494.37
4	61,166.22	172	97	75	56.40	1,619.88	-1,279.50	1.27	1.64	355.62
3	44,108.22	182	112	70	61.54	1,265.87	-1,395.27	0.91	1.45	242.35
2	40,184.57	198	110	88	55.56	1,228.05	-1,078.42	1.14	1.42	202.95
1	36,311.96	211	131	80	62.09	720.73	-726.30	0.99	1.62	172.09

The edge here is apparent from day one and suggests upside over the next couple of weeks. But now let's look at times like now when the strong selloff DOES immediately follow a 50-day high. (This study was last seen in the 10/20/10 Subscriber Letter. All stats are updated.)

SPX closes down at least 1% and NYSE decliners more than double
 advancers. Close > 200ma. Yesterday SPX closed at a 50-day high.
 Buy 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: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-1,599.61	17	10	7	58.82	1,286.12	-2,065.83	0.62	0.89	-94.09
4	3,502.39	17	11	6	64.71	1,211.44	-1,637.23	0.74	1.36	206.02
3	5,267.25	17	12	5	70.59	932.05	-1,183.46	0.79	1.89	309.84
2	1,824.63	18	11	7	61.11	899.80	-1,153.31	0.78	1.23	101.37
1	6,110.59	18	14	4	77.78	673.01	-827.88	0.81	2.85	339.48

The chance of a bounce the next day appears quite high. The entire extent of the upside edge is played out in the first day, though. For those who might want to take a closer look at the instances, I have listed them all below.

SPX closes down at least 1% and NYSE decliners more than double
 advancers. Close > 200ma. Yesterday SPX closed at a 50-day high.
 Buy on close. Sell X days later. \$100k/trade. 10/20/87 - present.

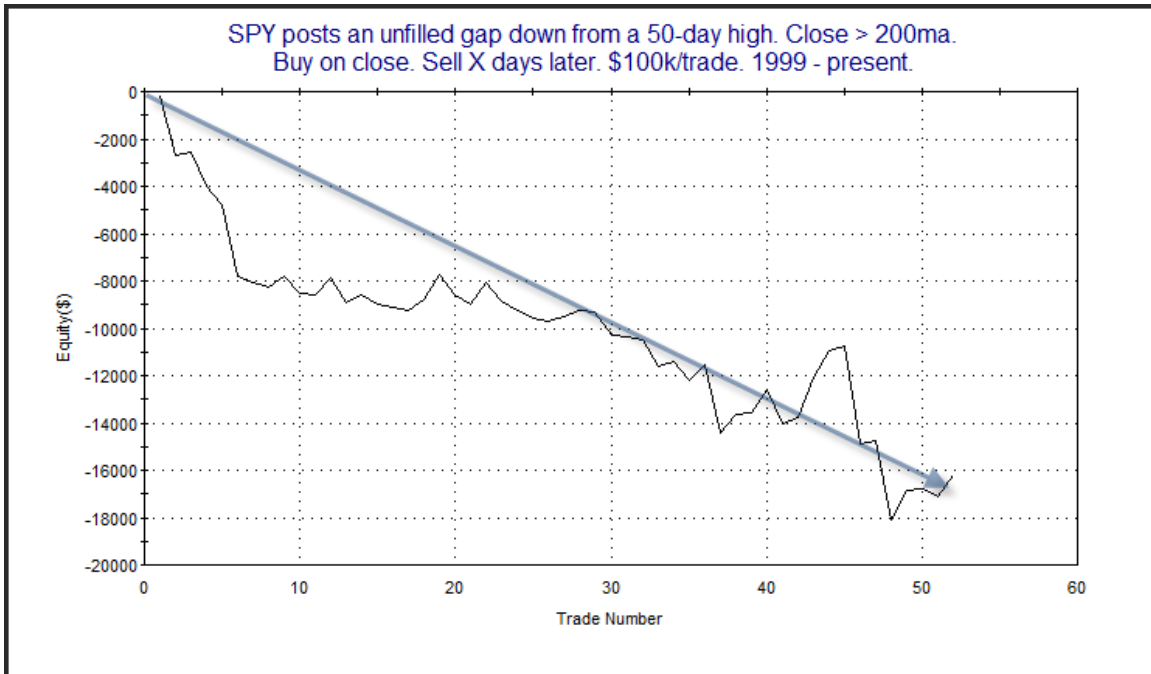
Date/Time	Signal	Price	% Profit	Run-up DrawDown
06/16/88	Buy	\$269.77	0.33%	\$370.00
06/17/88	Sell	\$270.67		(\$621.60)
02/20/91	Buy	\$365.13	(0.05%)	\$453.18
02/21/91	Sell	\$364.96		(\$171.99)
09/15/92	Buy	\$419.77	0.03%	\$633.08
09/16/92	Sell	\$419.91		(\$476.00)
06/23/97	Buy	\$878.62	2.02%	\$2,048.69
06/24/97	Sell	\$896.34		\$0.00
05/14/99	Buy	\$1,337.80	0.11%	\$159.10
05/17/99	Sell	\$1,339.31		(\$1,229.88)
03/20/02	Buy	\$1,151.85	0.15%	\$279.50
03/21/02	Sell	\$1,153.59		(\$1,063.82)
10/17/03	Buy	\$1,039.32	0.52%	\$514.56
10/20/03	Sell	\$1,044.68		(\$306.24)
01/25/07	Buy	\$1,423.90	(0.12%)	\$235.90
01/26/07	Sell	\$1,422.18		(\$485.80)
05/10/07	Buy	\$1,491.47	0.96%	\$989.59
05/11/07	Sell	\$1,505.85		\$0.00
07/20/07	Buy	\$1,534.10	0.49%	\$853.45
07/23/07	Sell	\$1,541.57		\$0.00
06/03/09	Buy	\$931.76	1.15%	\$1,145.97
06/04/09	Sell	\$942.46		(\$261.08)
06/15/09	Buy	\$923.72	(1.27%)	\$462.24
06/16/09	Sell	\$911.97		(\$1,308.96)
11/12/09	Buy	\$1,087.24	0.57%	\$960.05
11/13/09	Sell	\$1,093.48		(\$173.81)
11/27/09	Buy	\$1,091.50	0.38%	\$522.34
11/30/09	Sell	\$1,095.63		(\$477.75)
01/15/10	Buy	\$1,136.03	1.25%	\$1,268.96
01/19/10	Sell	\$1,150.23		(\$7.04)
01/20/10	Buy	\$1,138.04	(1.89%)	\$307.98
01/21/10	Sell	\$1,116.48		(\$2,018.40)
04/16/10	Buy	\$1,192.13	0.45%	\$476.42
04/19/10	Sell	\$1,197.52		(\$701.35)
10/19/10	Buy	\$1,165.90	1.05%	\$1,431.40
10/20/10	Sell	\$1,178.17		\$0.00

The Quantifinder tonight also identified some studies that examined SPY performance after posting an unfilled gap down from a high level. The one below is the one I found to be the most relevant. It was last shown in the 11/9/10 Subscriber Letter. Stats are updated.

SPY posts an unfilled gap down from a 50-day high. Close > 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: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-16,755.46	46	20	26	43.48	1,038.20	-1,443.05	0.72	0.55	-364.25
4	-8,799.22	46	23	23	50.00	831.94	-1,214.51	0.68	0.68	-191.29
3	-10,918.34	47	21	26	44.68	493.54	-818.56	0.60	0.49	-232.31
2	-16,222.86	52	22	30	42.31	579.88	-966.00	0.60	0.44	-311.98
1	-8,309.22	52	24	28	46.15	575.70	-790.22	0.73	0.62	-159.79

These unfilled gaps from high levels often tend to lead to more selling over the next few days. I ran an equity curve using a 2-day exit strategy to see what the edge has looked like over time.



The edge isn't huge, but it's been fairly consistent and it certainly appears worthy of consideration.

It's also worth noting that both of the bearish studies from last night reached their targets in just one day. They have therefore been removed from the short-term Active List, and are no longer included in the Aggregator calculation.

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



Wednesday's activity has helped move the green Aggregator line to a less bearish position, but it is still comfortably below 0. The negative value means the net expectation from the Active Studies List is for downside over the next few days. Meanwhile, Wednesday's sharp drop caused the black Differential line to spike above 0. The positive value means the SPX has underperformed expectations over the last few days. So net expectations are for downside but the SPX has underperformed recent expectations. This is considered a neutral configuration. A neutral configuration is evident on the chart whenever both lines are on opposite sides of zero. Due to this the Aggregator System changed from short to flat at the close.

The green Aggregator line is tentatively set up to remain below 0 on Thursday. Of course this could change if more bullish evidence emerges. Meanwhile the Differential Pivot will be 1,291.39. This is about 3/4% above Wednesday's close. This means it would take a rally of this magnitude for the SPX to be considered "overbought", and for the black Differential line to move back below zero.

I've moved to a neutral position and am now awaiting the next favorable risk/reward opportunity to present itself.

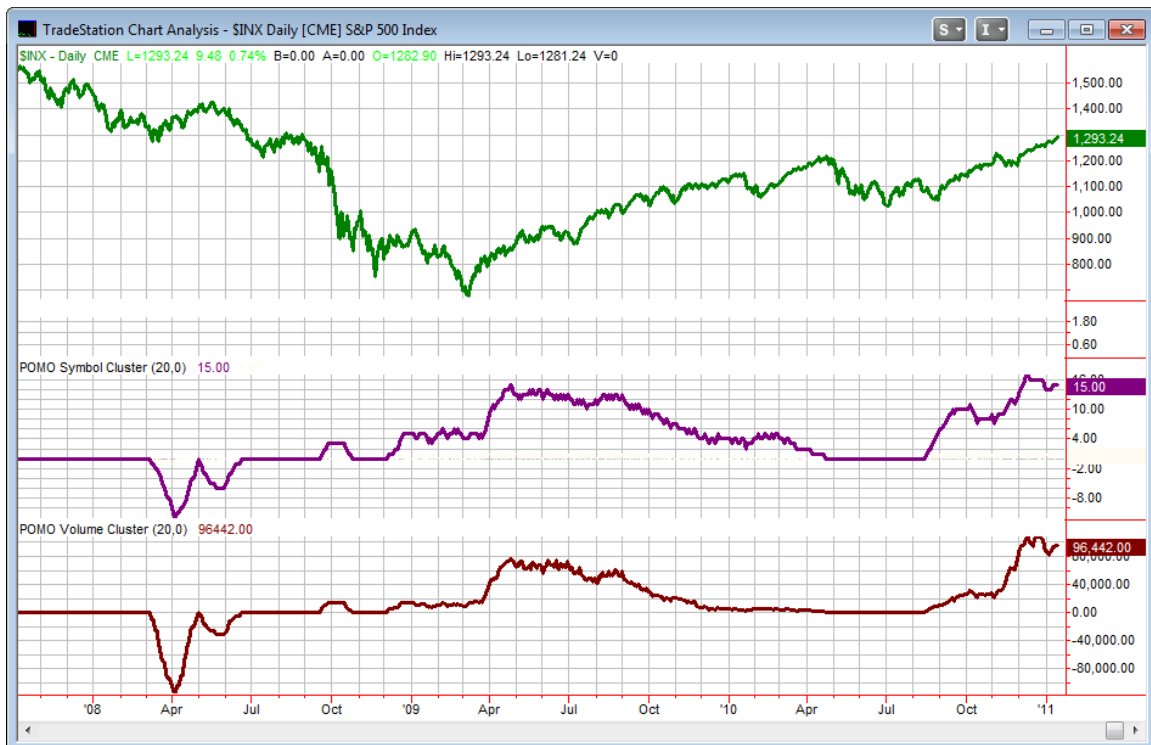
Intermediate-term Outlook (2 weeks – 2 months)– updated 1/18 - slightly bullish

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.

None 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	\$128.25	0.81%		covered on close

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