

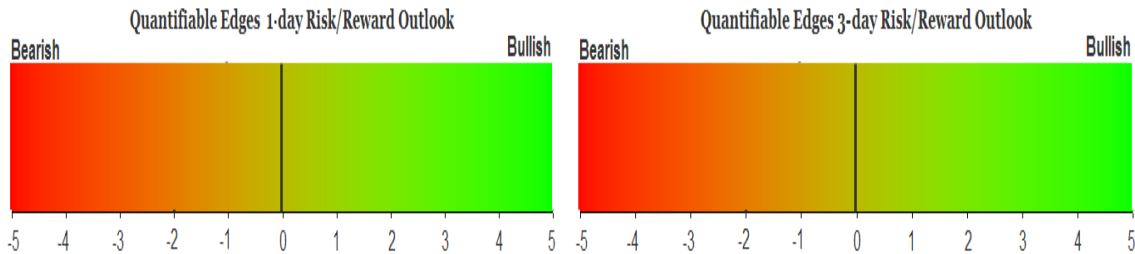
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 21, 2011

Volume 4 Issue 14

Market Overview



Tonight's Research Points

- The 1st dip below the 10ma for SPY after spending at least 25 days above it has always been buyable.
- SPY's partial reversal on Thursday following a 5-day closing low on Wednesday sets up a bullish scenario.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is long.

Short-term Outlook

The Bottom Line

The last 2 days action has moved the SPX into oversold position and has triggered some solidly bullish studies. I am now short-term bullish and looking to take advantage of possible upside.

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 21, 2011	1st close < 10ma in over 25 days	1-11 days	Bullish	3.60%
January 21, 2011	SPY gap down & partial revers fr 5-low	1-10 days	Bullish	3.20%
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 21, 2011	SPY 1st close < 10ma in over 25 days	1-20 days	Bullish	
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 20, 2011	1% Drop Decl 2x Adv from 50-high	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

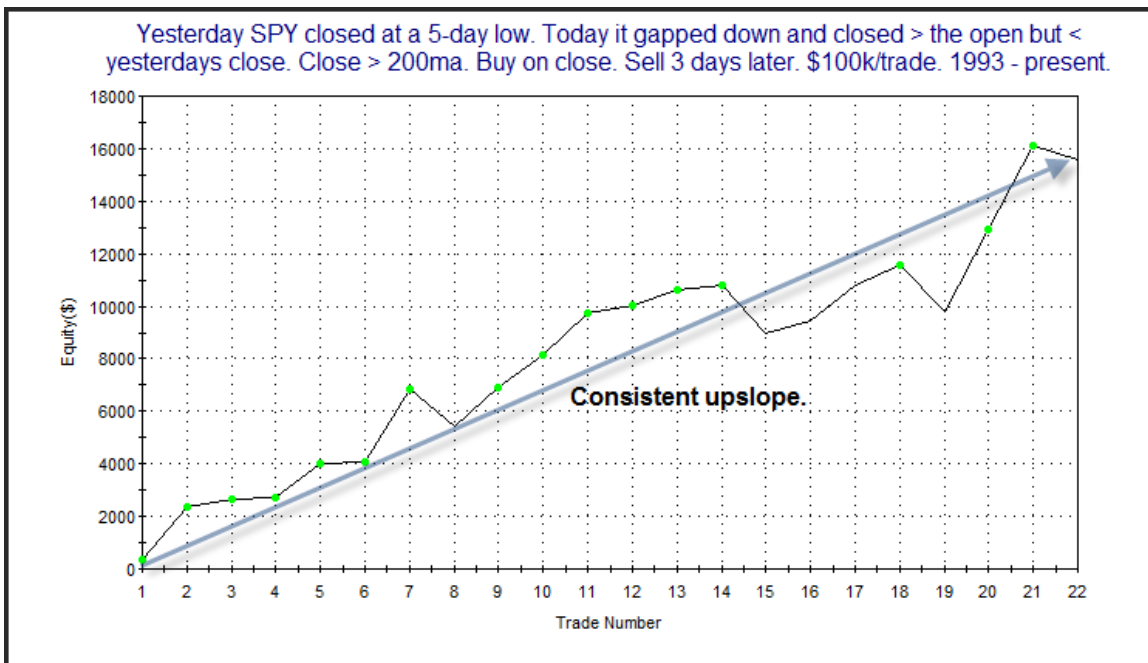
The market experienced some selling on Thursday, making it the second day in a row. The selloff was quite a bit worse in small and mid-cap stocks than in large-caps. The SPX finished with a mild 0.1% drop, the NASDAQ fell 0.8%, and the Russell 2000 again got the worst of it with a 1.1% decline. Breadth was weak as the NYSE Up Issues % came in at 39% and the Up Volume % was 48%. Total volume rose from Wednesday's level but fell short of Tuesday's mark.

The selling looked much worse late in the morning than it did during the afternoon. All the indices attempted to reverse strongly off their lows. The SPX made the best go of it. And although it didn't quite manage to close positive on the day, the SPY did close higher than it opened. This triggered a study from the 5/6/10 Subscriber Letter which I have updated below.

Yesterday SPY closed at a 5-day low. Today it gapped down and closed > the open but < yesterdays close. 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
12	39,433.61	21	17	4	80.95	3,316.05	-4,234.81	0.78	3.33	1,877.79
11	42,601.64	21	18	3	85.71	3,258.76	-5,351.99	0.61	3.65	2,028.65
10	42,365.75	21	17	4	80.95	3,200.84	-3,012.15	1.06	4.52	2,017.42
9	37,534.79	22	18	4	81.82	2,830.58	-3,353.91	0.84	3.80	1,706.13
8	37,893.33	22	16	6	72.73	2,978.30	-1,626.57	1.83	4.88	1,722.42
7	28,713.54	22	16	6	72.73	2,523.98	-1,945.03	1.30	3.46	1,305.16
6	23,487.95	22	14	8	63.64	2,276.97	-1,048.71	2.17	3.80	1,067.63
5	17,374.10	22	16	6	72.73	1,631.35	-1,454.57	1.12	2.99	789.73
4	15,314.96	22	15	7	68.18	1,650.24	-1,348.39	1.22	2.62	696.13
3	15,565.75	22	18	4	81.82	1,177.63	-1,407.91	0.84	3.76	707.53
2	9,736.51	22	16	6	72.73	1,197.33	-1,570.12	0.76	2.03	442.57
1	3,871.60	24	16	8	66.67	879.63	-1,275.30	0.69	1.38	161.32

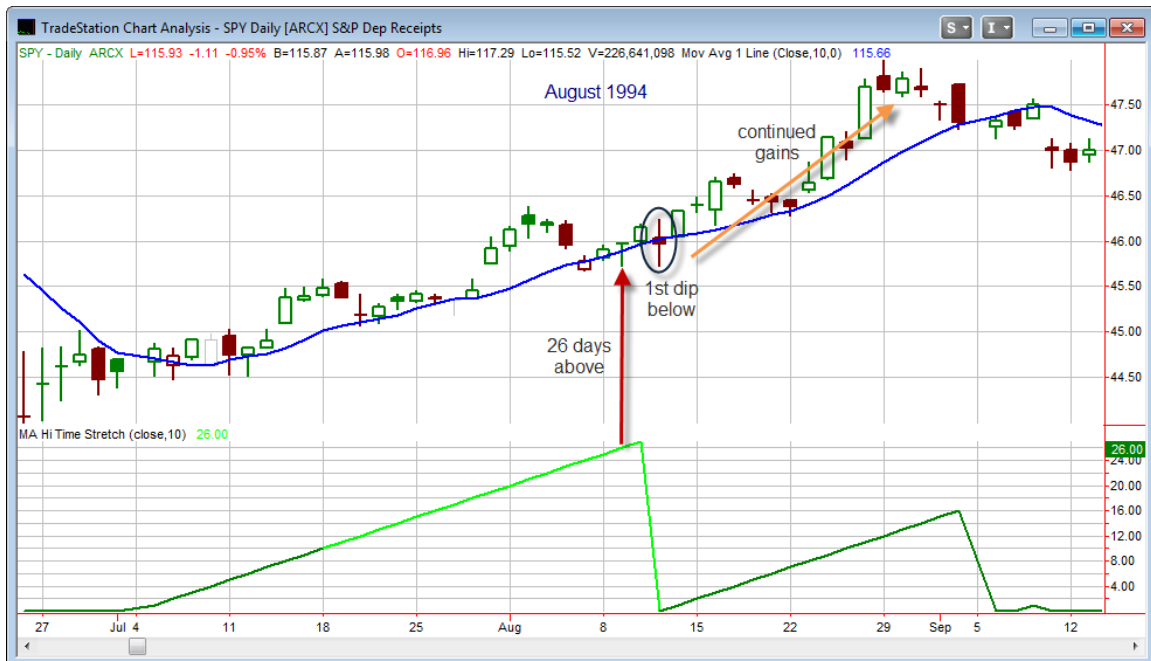
The stats here appear very strong, not only suggesting an immediate bounce, but also some strong follow through over the next couple of weeks. Below you can see the equity curve using a 3-day exit strategy.



I like the equity curve here. It has never wandered very far from the uptrend arrow.

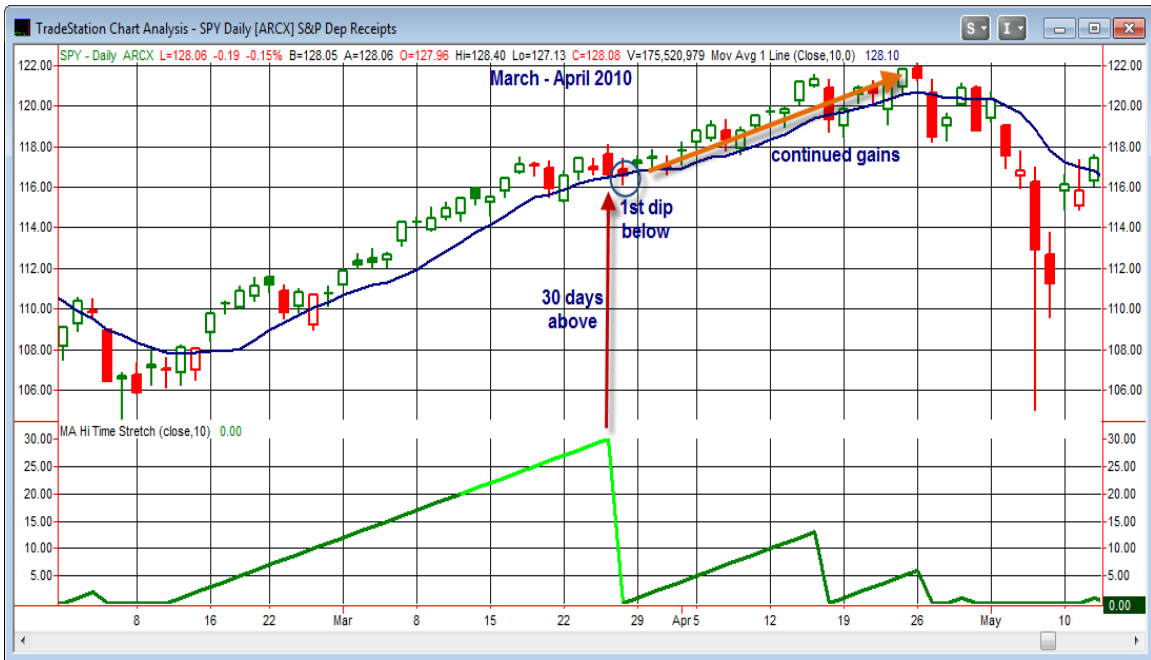
Also notable about Thursday's action is that the SPY closed below its 10ma for the first time since November 30th. In the December 30 Subscriber Letter I showed a study that examined SPX performance following an entire calendar month above the 10ma. It suggested bullish intermediate-term implications. Tonight the Quantifinder identified another study in the same vein as this December 30 one.

In the 3/22/10 Subscriber Letter I looked at all the instances where SPY had traded above its 10ma for at least 25 days. Since its inception in 1993 there were only five other instances (now six) where SPY had a run of 25 days or more. I showed the charts of every instance and noted how the market reacted after it finally did close beneath its 10ma. I noted that the first dip never had resulted in the end of the rally. Below I have republished those five charts and added a sixth one to show the March/April instance. The indicator in the bottom pane of each chart shows the number of days the SPY has closed above its 10ma.









These charts all looked eerily similar. A brief examination is all that's needed to see that the first trip below the 10ma was a short one, and the uptrend quickly reasserted itself. Of course if you've been reading Quantifiable Edges for any period of time, you're probably used to looking at numbers. So below you will find the stats table.

After closing above the 10ma for at least 25 days in a row, SPY closes below it today.
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	23,067.59	6	6	0	100.00	3,844.60	0.00	100.00	100.00	3,844.60
19	23,334.85	6	6	0	100.00	3,889.14	0.00	100.00	100.00	3,889.14
18	19,218.96	6	6	0	100.00	3,203.16	0.00	100.00	100.00	3,203.16
17	18,079.87	6	6	0	100.00	3,013.31	0.00	100.00	100.00	3,013.31
16	20,012.56	6	6	0	100.00	3,335.43	0.00	100.00	100.00	3,335.43
15	20,520.07	6	6	0	100.00	3,420.01	0.00	100.00	100.00	3,420.01
14	20,825.44	6	6	0	100.00	3,470.91	0.00	100.00	100.00	3,470.91
13	22,701.02	6	6	0	100.00	3,783.50	0.00	100.00	100.00	3,783.50
12	20,623.30	6	6	0	100.00	3,437.22	0.00	100.00	100.00	3,437.22
11	19,719.22	6	6	0	100.00	3,286.54	0.00	100.00	100.00	3,286.54
10	16,883.71	6	6	0	100.00	2,813.95	0.00	100.00	100.00	2,813.95
9	14,931.86	6	6	0	100.00	2,488.64	0.00	100.00	100.00	2,488.64
8	12,078.45	6	6	0	100.00	2,013.08	0.00	100.00	100.00	2,013.08
7	10,459.28	6	6	0	100.00	1,743.21	0.00	100.00	100.00	1,743.21
6	8,603.88	6	5	1	83.33	1,754.29	-167.58	10.47	52.34	1,433.98
5	8,858.67	6	5	1	83.33	1,863.46	-458.64	4.06	20.32	1,476.45
4	8,955.55	6	6	0	100.00	1,492.59	0.00	100.00	100.00	1,492.59
3	6,556.29	6	6	0	100.00	1,092.72	0.00	100.00	100.00	1,092.72
2	3,217.02	6	5	1	83.33	690.12	-233.60	2.95	14.77	536.17
1	3,331.20	6	4	2	66.67	872.09	-78.58	11.10	22.20	555.20

Strong and persistent upside movement like we have seen lately hasn't just ended and lead to an immediate correction. The 1st dip has always been just that – a dip. New highs were always made in short order. After these new highs were made there may have been a loss of momentum that turned into a substantial top. It never came on the 1st dip, though – and the 1st dip is where we are now. The caveat here is obviously the very low sample size. But with every instance positive not just for a day or 2, but for 16 of the next 20 days, I find these results very compelling. (In fact all 6 remain positive through day 27.) I have decided to include this study on both the short and intermediate-term Active List.

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



Tonight's bullish studies have helped to quickly move the green Aggregator line back above 0. The positive value means the net expectation from the Active Studies List is for upside over the next few days. Meanwhile, the black Differential line is now well above 0. The positive value means the SPX has underperformed expectations over the last few days. So net expectations are for upside and the SPX has underperformed recent expectations. Historically this combination has indicated a bullish edge. A positive

configuration is evident on the chart whenever both lines are above zero. Due to this the Aggregator System changed from flat to long at the close.

The green Aggregator line is tentatively set up to remain above 0 on Friday. Of course this could change if more bearish evidence emerges. Meanwhile the Differential Pivot will be 1,290.60. This is about 0.8% above Thursday'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.

The pullback the last two days and the subsequent bullish studies that have emerged have begun to turn my short-term outlook quite positive. I am looking to take on long exposure and have included some examples in the Trade Ideas section below.

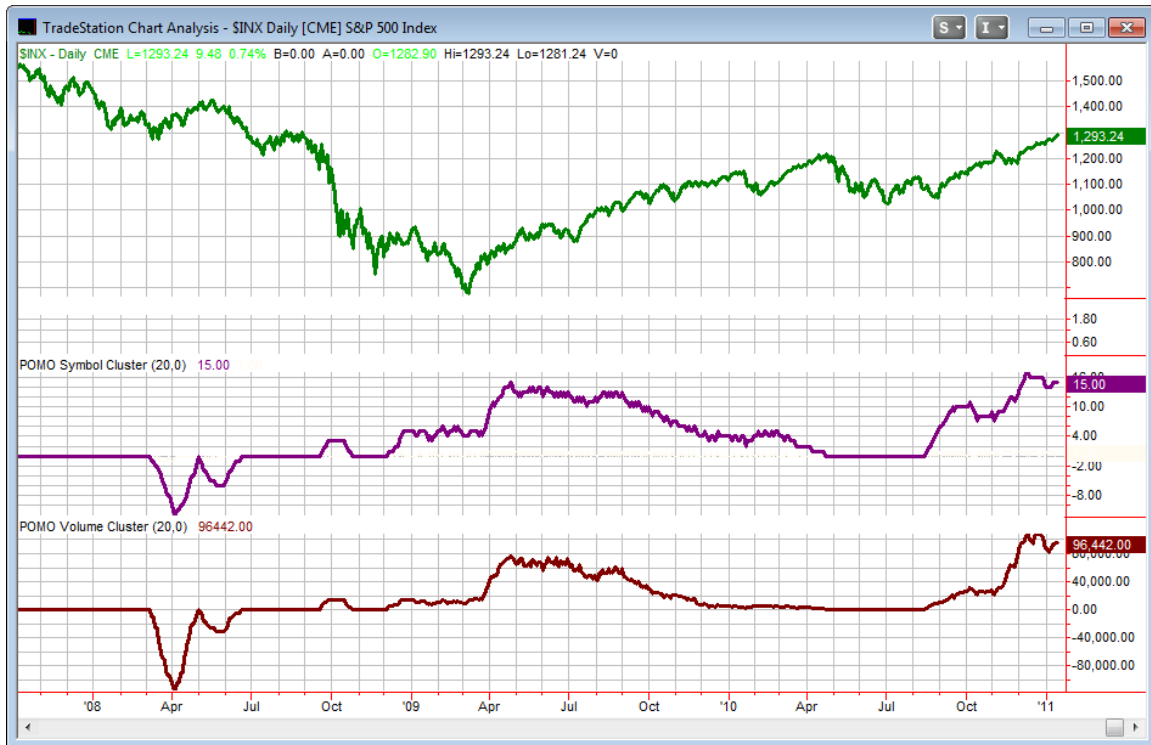
Intermediate-term Outlook (2 weeks – 2 months)– updated 1/18 - slightly bullish

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 – buy ¼ index position @ \$128.08 LIMIT. Based on short-term outlook above.

EWJ – buy @ \$11.06 limit. From the system triggers spreadsheet, EWJ triggered system 11111. Also, like SPY, it closed below its 10ma for the 1st time since November tonight. I intend to track and trade it as a 11111 trade, but it could be tradable for a longer holding period than 11111 might suggest.

Current Open Trade Ideas

None.

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