

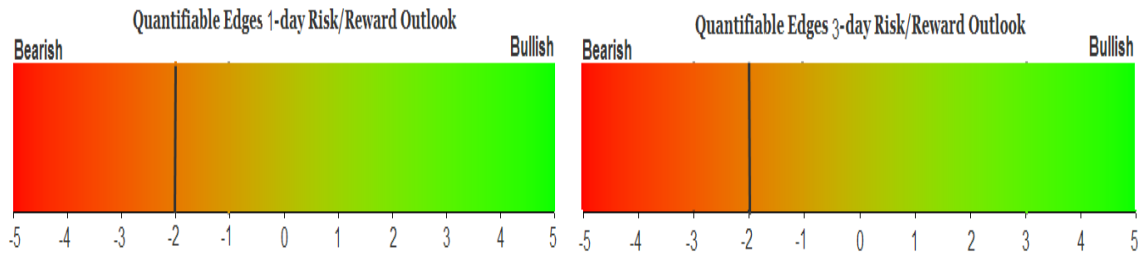
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 14, 2011

Volume 4 Issue 30

Market Overview



Tonight's Research Points

- Constant closes in the upper end of the day's range often precede a pullback.
- The Aggregator System is short.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook

The Bottom Line

The SPX is overbought and the short-term studies continue to suggest a downside edge. I'm partially short and looking to take advantage of the edge.

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				
February 14, 2011	SPY 8-day avg closing range > 75	1-2 days	Bearish	-1.50%
February 7, 2011	200-day high on 1st Friday of Month	1-6 days	Bearish	-1.90%
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	
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				
February 8, 2011	20-day high on 20-day low vol.	1-4 days	Bearish	-1.65%
February 11, 2011	SPX up < 0.25% and top 10% of range	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

On Friday the market again saw a morning dip turn to an afternoon rally. The major indices all finished higher. The SPX gained 0.6%, the Nasdaq was up 0.7% and the Russell 2000 rose 1.2%. Breadth was solidly positive as the NYSE Up Issues % came in at 70% and the Up Volume % was 72%. Total NYSE volume declined some from Thursday’s levels.

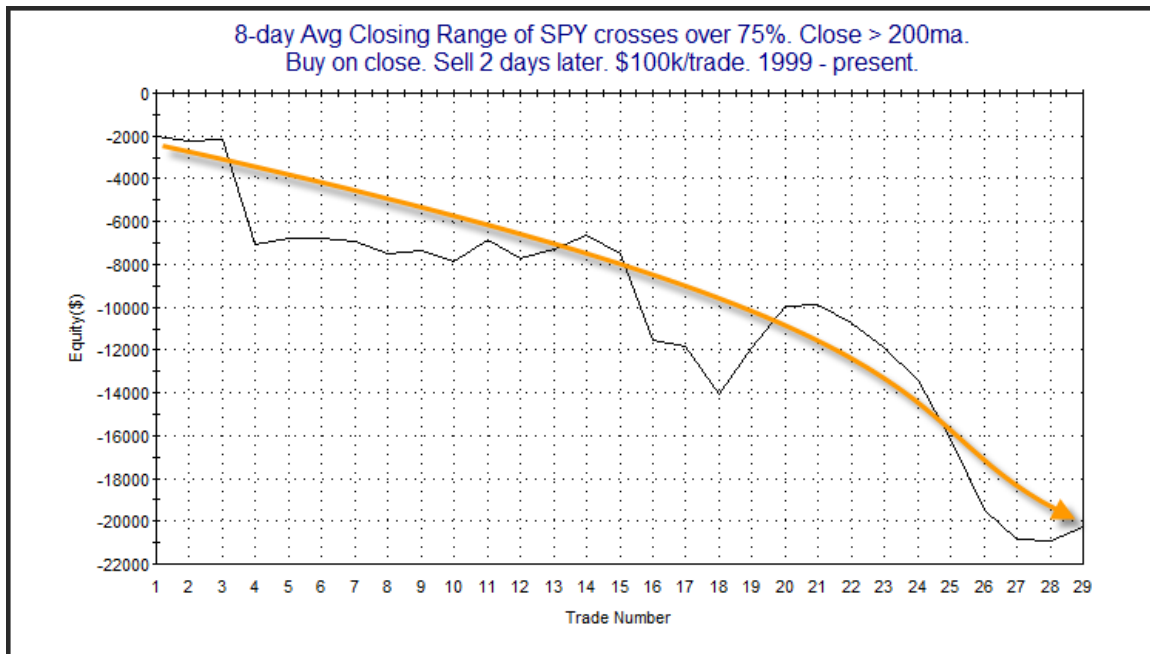
It has been a very odd (and somewhat frustrating) grind higher the last several days. There have been several bearish studies arise and a complete lack of evidence suggesting the market was likely to continue higher (over the short-term). The bearish studies have been based on light volume, seasonality, and price action. It is very rare that bearish studies will consistently overwhelm bullish ones during an uptrend, but that is what has been happening.

Very little showed up suggesting an edge based on Friday’s action. The study below is one gold subscribers will quickly recognize since it just triggered a couple of nights ago. Consistent strong closes at the end of the day rarely continue for very long. The study below uses an 8-day average of the closing % range. When it has become overdone that has commonly been followed by a market pullback. This is demonstrated below.

8-day Avg Closing Range of SPY crosses over 75%. 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	-23,347.72	25	11	14	44.00	898.10	-2,373.34	0.38	0.30	-933.91
4	-19,366.43	25	10	15	40.00	1,009.34	-1,963.99	0.51	0.34	-774.66
3	-18,306.59	26	9	17	34.62	862.56	-1,533.51	0.56	0.30	-704.10
2	-20,281.80	29	10	19	34.48	736.44	-1,455.06	0.51	0.27	-699.37
1	-10,120.36	29	12	17	41.38	278.93	-792.21	0.35	0.25	-348.98

24 of 29 instances (83%) posted a close below the entry price on either day 1 or day 2.

The stats continue to suggest a downside edge. The last two days didn’t comply but we are now back into “overbought” territory. Below is the equity curve using a 2-day exit strategy.

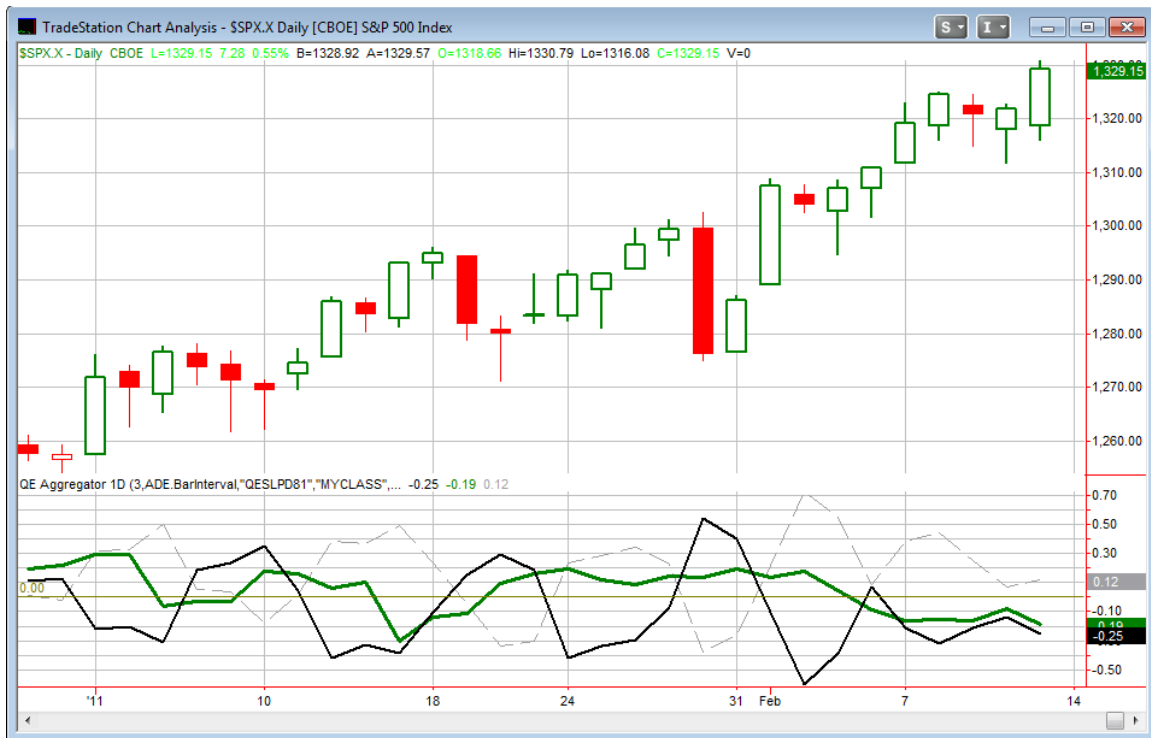


The slope of the curve has consistently been down and despite the last couple of instances that hasn't changed.

This tendency to finish near the highs has persisted now for a good 10 days rather than the 8-day measurement I use in the study. The 10-day average is currently 77.65%. Over the '99 – present time period that I have been looking at there have only been 9 instances where the 10-day average has risen above 75%. The last was in July of 2009. Every instance was followed by a close below the trigger-day close within the next 4 days. This isn't much of a sample size, but it is more confirmation that the strong closes have become overdone.

The Quantifinder also noted that next week is op-ex week. Often op-ex week has suggested bullish implications. I looked at this in March 2010 and broke returns out by month. February is one of the weaker months. Over the last many years there has been no upside edge during February op-ex week. The next 2 months this will not be the case. March and April have both shown strong seasonality during op-ex week.

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



There is still nothing but bearish studies for the short-term so the green Aggregator line remains squarely below zero. 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 also below 0. The pullback wasn't quite enough to bring the Differential line back above zero and Friday's action forced it lower again. Readings below 0 mean the SPX has outperformed expectations over the last few days. So net expectations are for downside and the SPX has outperformed recent expectations. Historically this configuration has suggested a bearish edge. A bearish configuration is evident on the chart whenever both lines are below zero. Due to this the Aggregator System remained short at the close.

Based on the current active studies the green Aggregator line is set to remain below 0 on Friday. Since there are so few active short-term studies currently this could change if even moderate bullish evidence emerges. Meanwhile the Differential Pivot will be at 1,314.43. This is about 1.1% below Thursday's close. For the Differential Line to move back above zero it would require the SPX to drop at least this much.

So we will need a bit of a selloff in order to move the Differential line back above 0, but a selloff could trigger some bullish studies that would move the Aggregator back above 0. I've been short SPY for a few days now and looking for a pullback to cover. I try not

to push my luck in counter-trend trades and also do not take large positions. Should we get the expected pullback in the next day or so then I will not hesitate to cover my short index position.

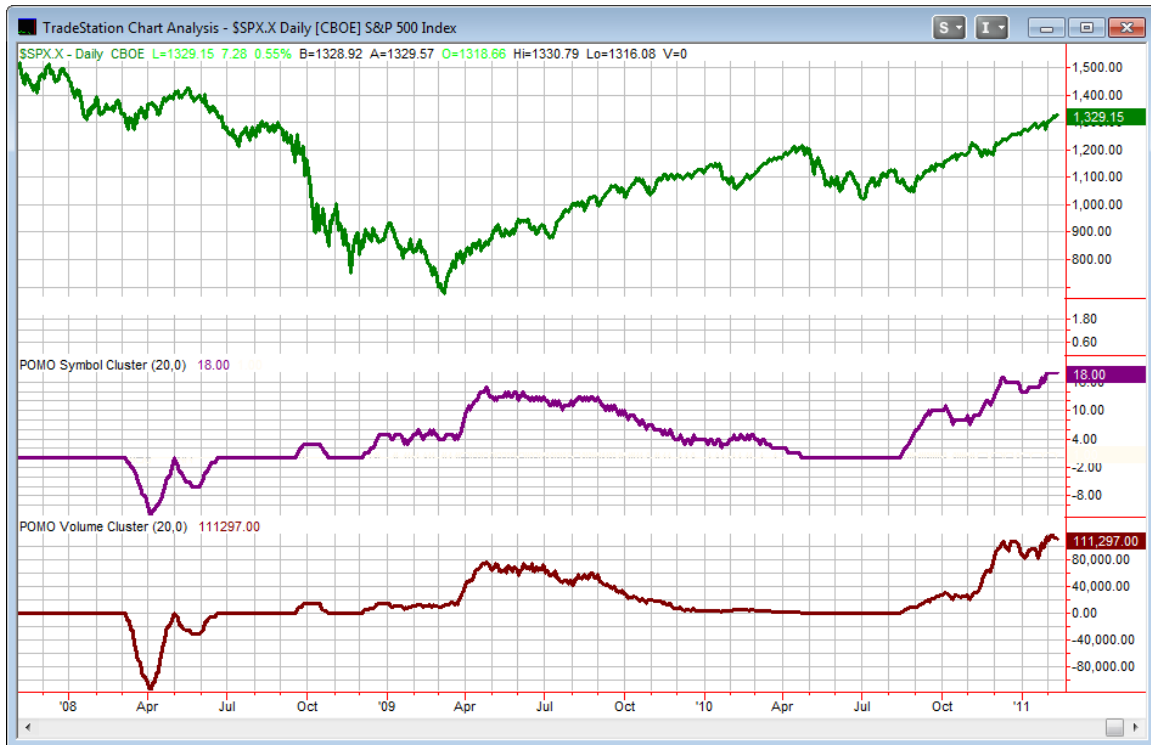
Intermediate-term Outlook (2 weeks – 2 months)– updated 2/14 - bullish

The market continues to make new highs. There can be no doubt we are in an intermediate-term uptrend. And while evidence is mixed, most signs continue to point up.

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 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 levels remain at or near all-time highs. This has almost certainly provided a strong boost to the market. On Thursday the Fed released its tentative operations schedule for the next month. A link to the schedule is below. After eyeballing it, it appears that POMO activity will be extremely strong. Operations are schedule for almost every day, and most days look to have a substantial amount of buying. This should continue to put a nice wind at the market's back.

http://www.newyorkfed.org/markets/tot_operation_schedule.html

Bulls still have POMO, trend, and momentum on their side, while the bears hopes continue to hinge on bond action. Short-term evidence is suggesting a pullback, but there is little suggesting that a pullback would mark the end of the uptrend. I'll continue to side with the bulls. From my standpoint this means I'll trade the long side more aggressively and the short side more conservatively.

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.

No new trade ideas tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	2/7/2011	\$131.97	\$133.11	-0.86%		Aggregator
SPY(1/4)(s)	2/8/2011	\$132.57	\$133.11	-0.41%		Aggregator

I will exit the SPY trade idea if the SPX drops strongly and closes at or below the Differential Pivot of 1,314.43. Should this not happen I will monitor action closely on Monday anyway. If bullish evidence emerges I may send out an intraday update that would suggest an exit at the close.

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