

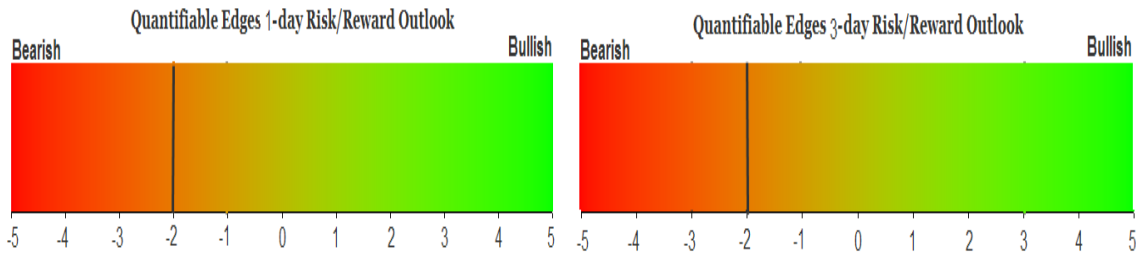
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 15, 2011

Volume 4 Issue 31

Market Overview



Tonight's Research Points

- The SPX has gone long enough without even a minor pullback, suggesting one is likely to come soon.
- SPX and VIX both closing higher on a Monday means Tuesday is often lower.
- A 20-day high on a 20-day low in NYSE volume is typically followed by a pullback.
- The dropping volatility suggests a sharp move could be on tap in the next few days.
- The Aggregator System is short.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook

The Bottom Line

The slow drift higher continues to suggest a pullback is likely.

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 15, 2011	SPY 10 days > 5ma & 10-day high	1-2 days	Bearish	-1.20%
February 15, 2011	SPX up VIX up on Monday	1 day	Bearish	
February 15, 2011	20-day high on 20-day low vol.	1-2 days	Bearish	-1.10%
February 14, 2011	SPY 8-day avg closing range > 75	1-2 days	Bearish	-1.50%
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 7, 2011	200-day high on 1st Friday of Month	1-6 days	Bearish	-1.90%

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

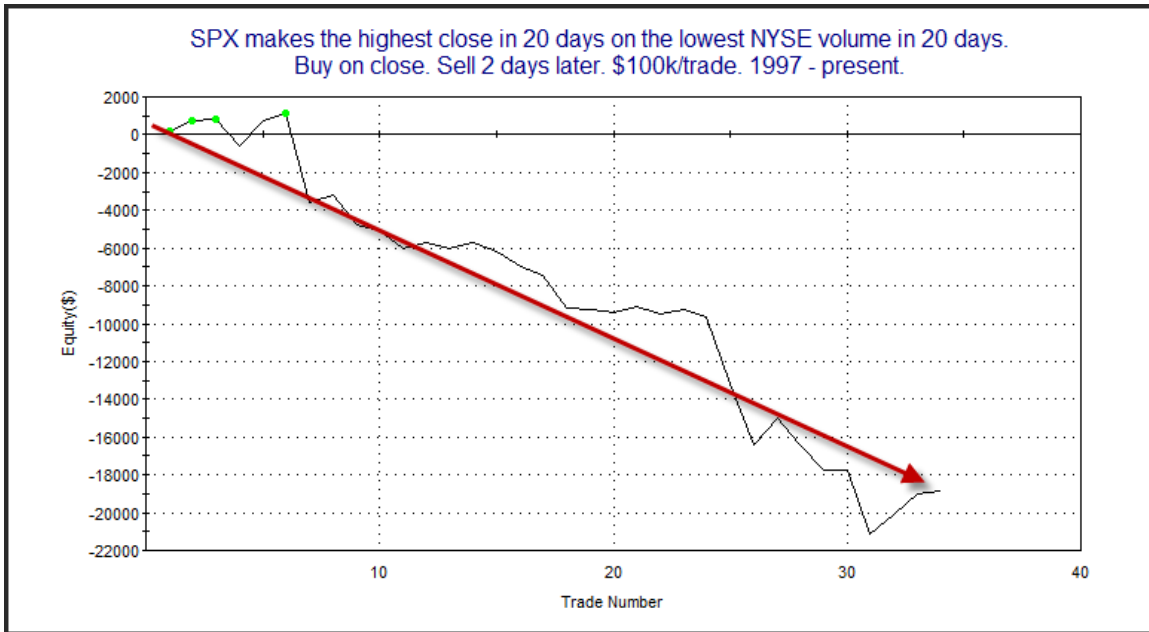
The Evidence

Monday saw another low-volume drift higher on the NYSE. The major indices all finished moderately higher. The SPX gained 0.2%, the Nasdaq was up 0.3% and the Russell 2000 added 0.5%. Breadth was mildly positive. The NYSE Up Issues % came in at 55% and the Up Volume % was 60%. Total NYSE volume came in extremely light. In fact it was easily the lightest day of 2011.

Several studies appeared tonight that examined the low volume / high price combination we saw today. Below is one was that was last updated in the 2/8/11 Letter.

SPX makes the highest close in 20 days on the lowest NYSE volume in 20 days. Buy on close. Sell X days later. \$100k/trade. 1997 - 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	-18,150.04	31	12	19	38.71	1,250.04	-1,744.77	0.72	0.45	-585.49
4	-18,316.46	32	11	21	34.38	1,019.89	-1,406.44	0.73	0.38	-572.39
3	-17,457.06	32	12	20	37.50	808.86	-1,358.17	0.60	0.36	-545.53
2	-18,865.18	34	14	20	41.18	564.13	-1,338.15	0.42	0.30	-554.86
1	-8,982.01	36	15	21	41.67	312.75	-651.11	0.48	0.34	-249.50

Results here appear to be squarely bearish. To help visualize how the edge has played out over time I produced the equity curve below using a 2-day exit strategy.



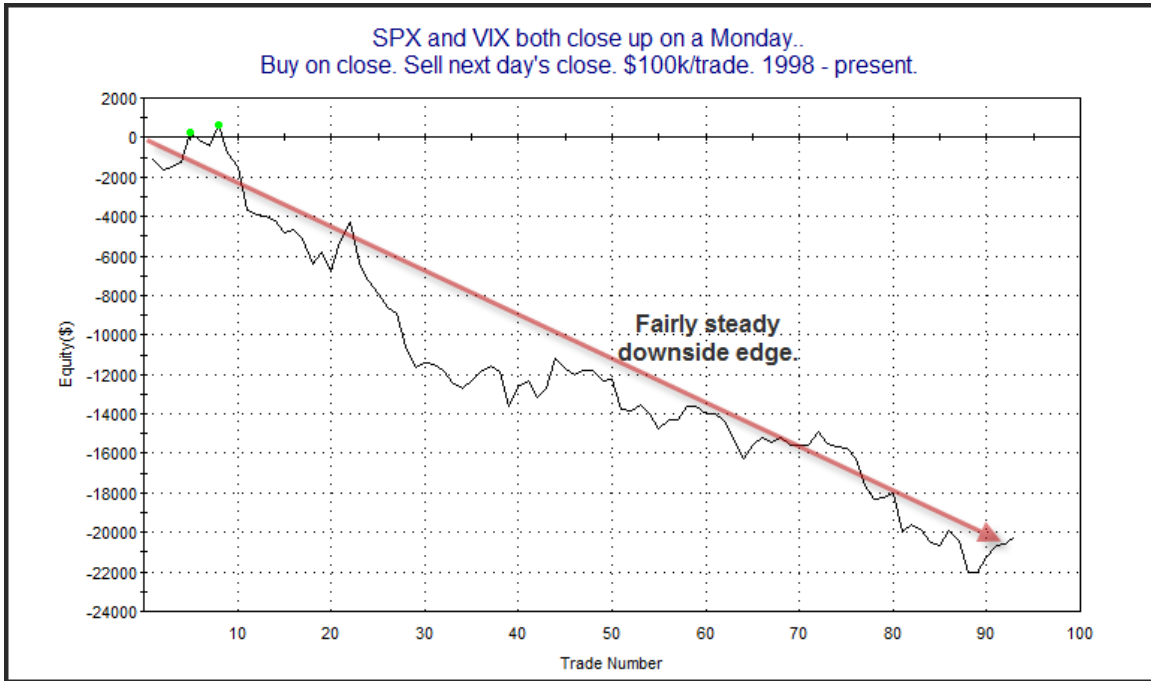
The last few instances have seen the market move higher over the next two days, but the curve still has a steady, downward appearance.

Also notable on Monday was that the VIX ended higher along with the SPX. It's a bit unusual for the SPX and the VIX to close in the same direction. Historically, when they both close higher there has been some giveback from the S&P over the next few days. One quirk with the VIX though is that it has a tendency to fall on Fridays and rise on Mondays. Therefore this setup is more common on Mondays than any other day of the week. Notably, this condition was also present and discussed on the 8/10/10 subscriber letter, though it was most recently updated on 2/8/11. I've again updated the study below.

SPX and VIX both close up on a Monday..
Buy on close. Sell X days later. \$100k/trade. 1998 - 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	-103.43	90	47	43	52.22	1,453.90	-1,591.55	0.91	1.00	-1.15
4	-8,113.46	93	45	48	48.39	1,263.86	-1,353.90	0.93	0.88	-87.24
3	-13,690.76	93	44	49	47.31	1,023.54	-1,198.50	0.85	0.77	-147.21
2	-18,187.53	93	41	52	44.09	735.18	-929.42	0.79	0.62	-195.56
1	-20,181.52	93	38	55	40.86	469.09	-691.03	0.68	0.47	-217.01

This appears to suggest a 1-day edge. Below is the equity curve so you can see how it has played out over time.



For a bearish study above the 200ma the edge shown here has been pretty consistent. I've included this among the active studies.

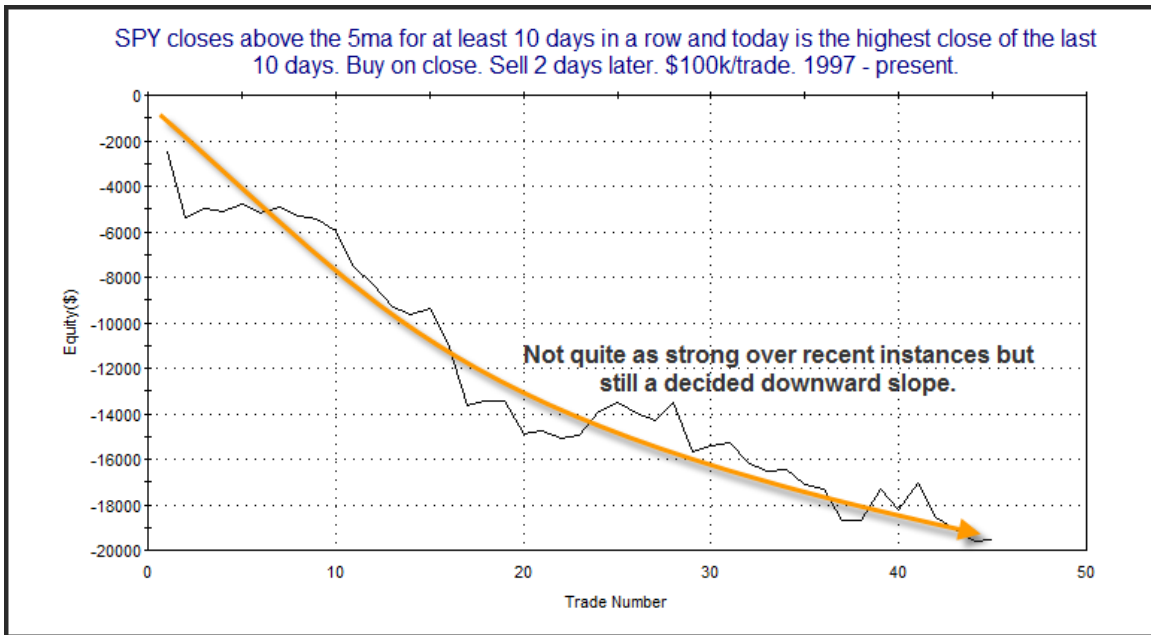
This next study was last seen in the 12/15/10 Letter. It examined rallies that spent an extended amount of time above the 5ma without pulling back. I've updated the results below.

SPY closes above the 5ma for at least 10 days in a row and today is the highest close of the last 10 days. Buy on close. Sell X days later. \$100k/trade. 1997 - 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	-8,935.09	34	20	14	58.82	752.39	-1,713.06	0.44	0.63	-262.80
4	-15,790.05	35	14	21	40.00	669.09	-1,197.97	0.56	0.37	-451.14
3	-17,264.21	41	13	28	31.71	656.57	-921.41	0.71	0.33	-421.08
2	-19,513.37	45	17	27	37.78	415.10	-984.08	0.42	0.27	-433.63
1	-19,309.04	64	25	39	39.06	321.23	-701.02	0.46	0.29	-301.70

34 of 38 instances (89%) posted a close below the entry price at some point in the next 4 days.

Such persistence doesn't typically last much longer before a pullback is seen. We see above what appears to be a decent downside edge. It appears most of the downside damage is done in the first 2 days. To see how the edge has played out over time I've produced an equity curve using a 2-day exit strategy.

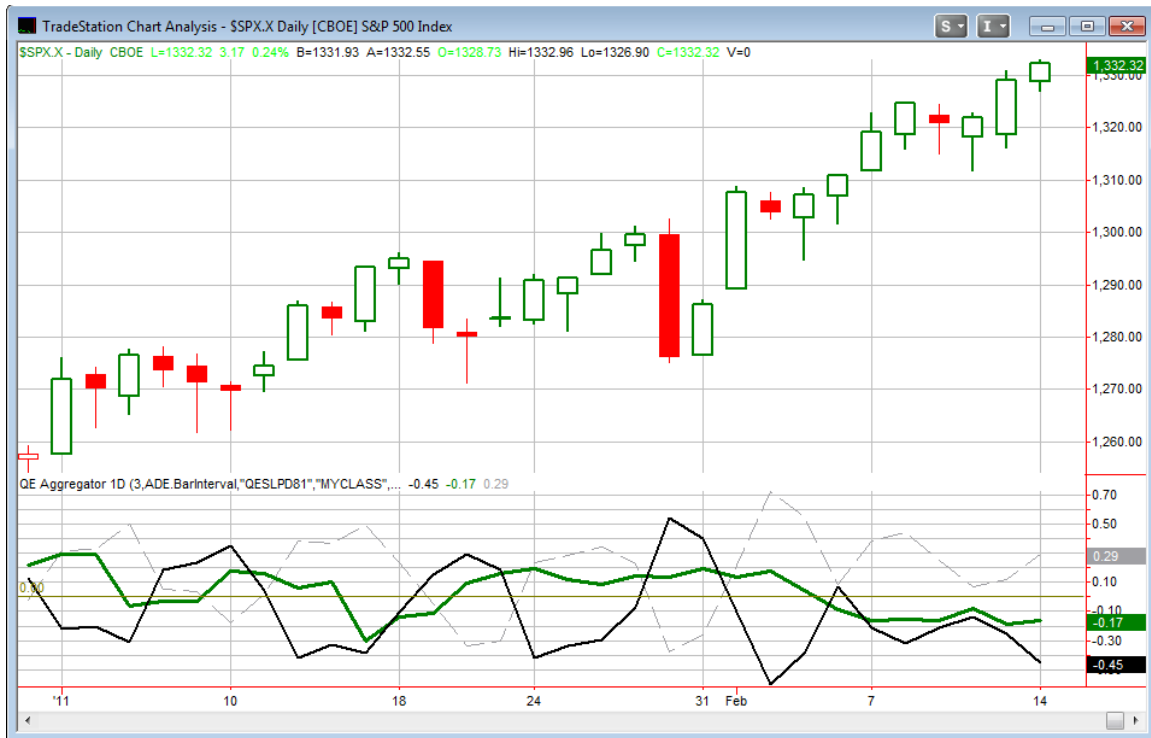


Though the slope has flattened a little, this still appears to suggest a downside edge.

Also notable is that the SPX 3/10 Offset HV indicator dropped below 0.25. In the past this has suggested a large move could occur over the next few days. It does not predict

the direction of the move. More information on this indicator may be found in the [7/13/09 blog](#).

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. 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 Tuesday. This could change if bullish evidence emerges. Meanwhile the Differential Pivot will be at 1,316.43. This is about 1.2% below Monday's close. For the Differential Line to move above zero it would require the SPX to drop at least this much.

I'm still holding tight to my half-size short position. While it can be tempting to continue scaling in, it can be dangerous when you are trading counter to the current trend. As for now I'm waiting for the studies to turn or the market to drop back down to "underperforming" before exiting.

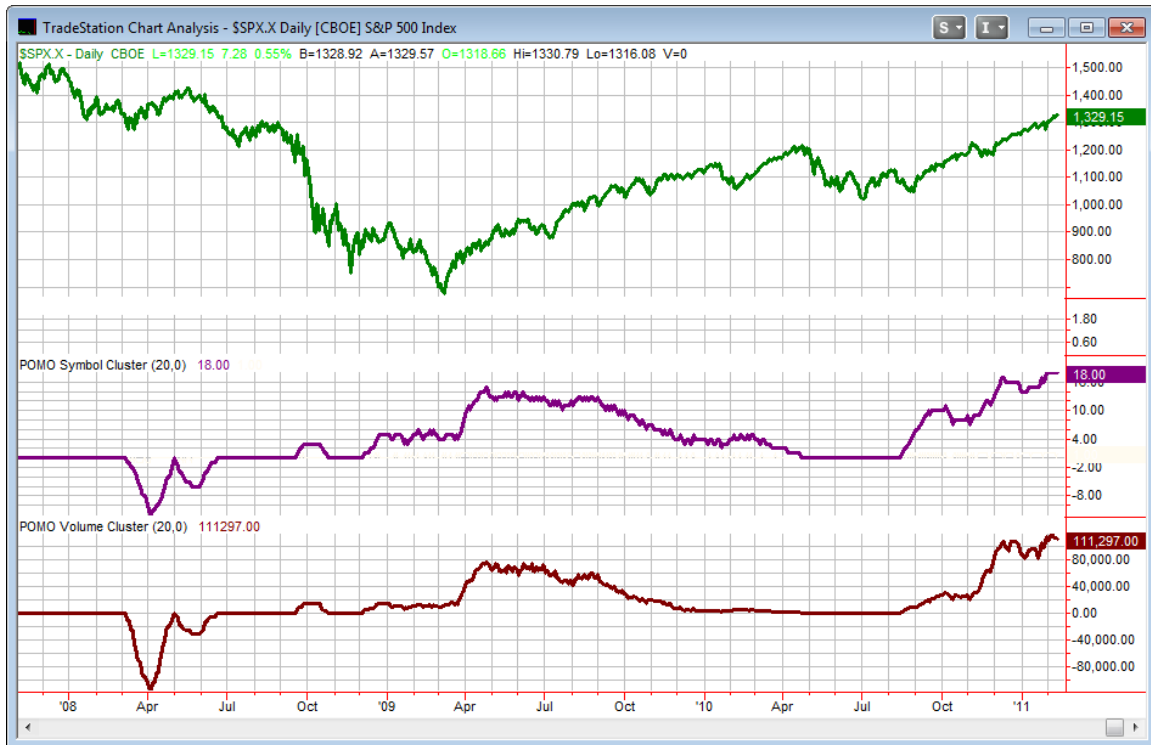
Intermediate-term Outlook (2 weeks – 2 months)– updated 2/14 - bullish

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	\$133.43	-1.11%		Aggregator
SPY(1/4)(s)	2/8/2011	\$132.57	\$133.43	-0.65%		Aggregator

I will exit the SPY trade idea if the SPX drops strongly and closes at or below the Differential Pivot of 1,316.43. Should this not happen I will monitor action closely on Tuesday anyway. If bullish evidence emerges I may send out an intraday update that would suggest an exit at the close.

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