

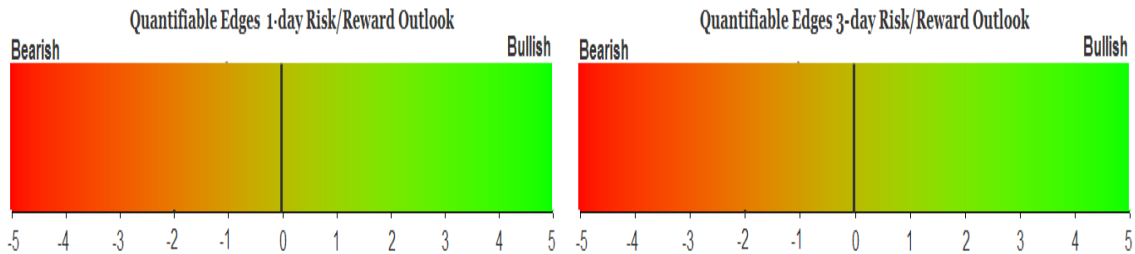
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 28, 2011

Volume 4 Issue 39

Market Overview



Tonight's Research Points

- Strong reversals off lows that don't turn the market overbought are often followed by further upside.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook

The Bottom Line

Evidence is bullish but the market has become a bit overdone very quickly. I'm looking to step out and wait for the next substantial 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 28, 2011	Bounce from low still not overbought	1-4 days	Bullish	1.60%
February 25, 2011	3 days dn. Drop slowing.	1-4 days	Bullish	
February 25, 2011	SPY gap dn and partial reverse	1-3 days	Bullish	
February 24, 2011	Down 1.75% and the between .25-.75%	1-5 days	Bullish	
Active - Long Term				
February 23, 2011	From 20 hi to 1st 5low in 10 days.	1-11 days	Bullish	
November 22, 2010	High number of POMO Days recently	int term	Bullish	
October 25, 2010	SPX Golden Cross	int term	Bullish	
Dropped Tonight				
December 9, 2010	SPX & TNX 50-day highs	1-50 days	Bearish	

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

The Evidence

Evidence became compelling on Thursday and the market popped right on schedule Friday. The major indices all put in strong moves. The SPX gained 1.1%, the Nasdaq was up 1.6%, and the Russell 2000 rose 2.2%. Breadth was strongly positive as the NYSE Up Issues % came in at 80% and the Up Volume % was 85%. Total NYSE volume took a big dip, though. It came in at the lowest level since Thursday the 17th.

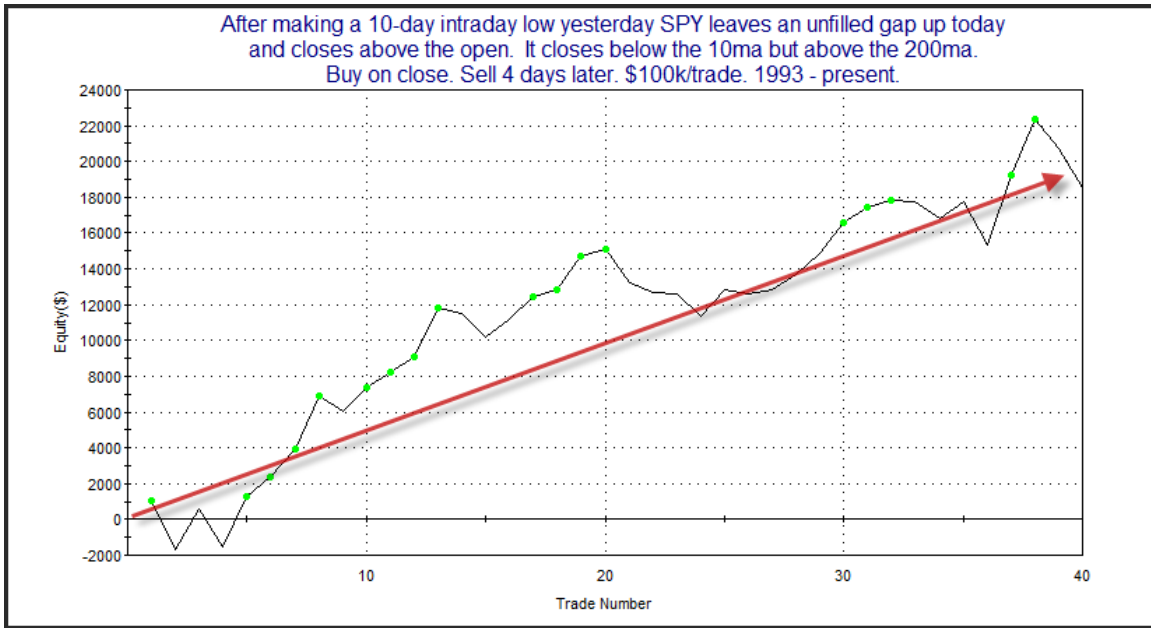
The price action in SPY showed some real strength in that it gapped up, never filled, and closed above the open. When the market is coming off an oversold level in an uptrend and is still not overbought, this pattern will often be followed by further gains. This is demonstrated in the study below.

After making a 10-day intraday low yesterday SPY leaves an unfilled gap up today and closes above the open. It closes below the 10ma but above the 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
10	24,317.82	35	22	13	62.86	2,140.36	-1,751.55	1.22	2.07	694.79
9	31,220.60	36	20	16	55.56	2,541.82	-1,225.99	2.07	2.59	867.24
8	30,232.75	36	24	12	66.67	2,037.29	-1,555.19	1.31	2.62	839.80
7	32,458.32	37	24	12	64.86	2,240.52	-1,776.17	1.26	2.52	877.25
6	22,796.80	39	23	16	58.97	1,952.77	-1,382.31	1.41	2.03	584.53
5	16,006.11	39	23	16	58.97	1,686.93	-1,424.58	1.18	1.70	410.41
4	18,542.09	40	25	15	62.50	1,484.86	-1,238.62	1.20	2.00	463.55
3	6,047.47	42	23	19	54.76	1,149.20	-1,072.84	1.07	1.30	143.99
2	5,960.23	42	24	18	57.14	1,034.85	-1,048.68	0.99	1.32	141.91
1	477.55	42	18	23	42.86	869.05	-659.36	1.32	1.03	11.37

93% of instances posted a close above the entry price at some point in the next week.

Results here appear to suggest a solid edge over the next several days. With 93% showing further gains at some point in the next week, the reliability of the setup appears very good. To get an idea of how the edge has played out over time I have run the equity curve below using a 4-day exit parameter.



The slope has remained upwards for a long time. While it isn't perfectly smooth it does appear to confirm the upside edge suggested by the stats table.

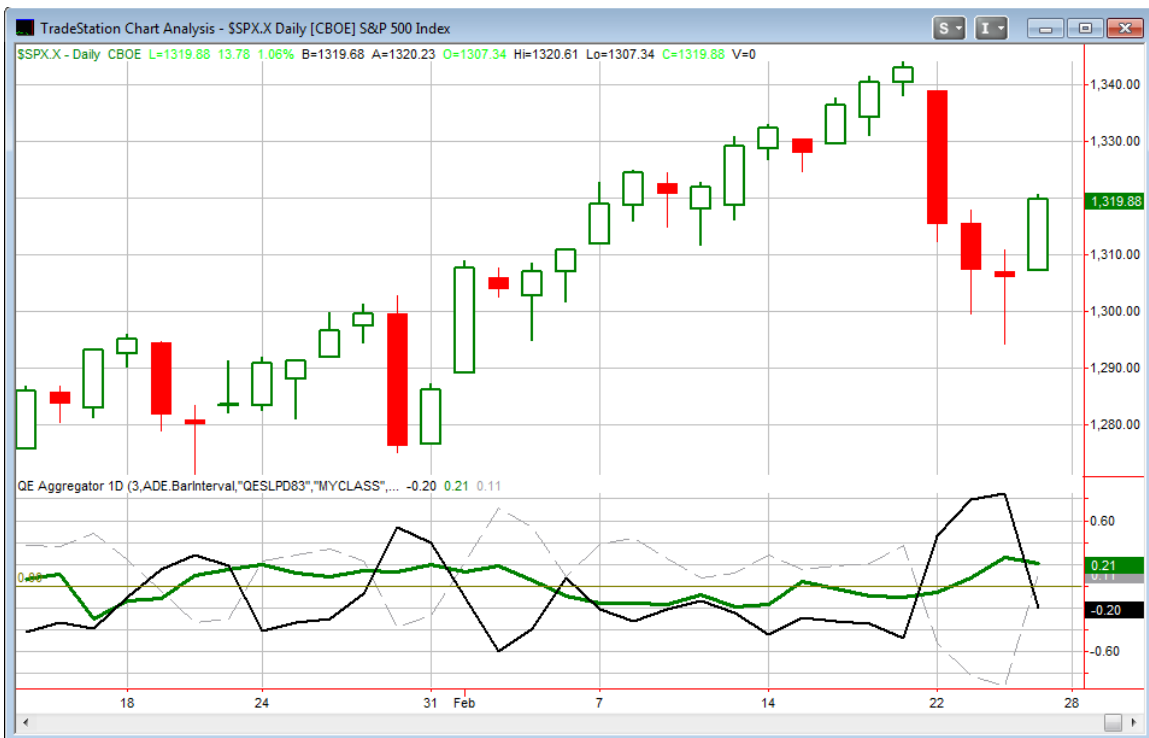
While the fact that the SPY closed below the 10ma may seem of minor importance, it does make a difference. Most instances that quickly go from the 10-day low back above the 10ma may be quickly moving from oversold to overbought. This makes further gains more difficult. This can be seen in the table below where I ran the same study but looked at time the SPY closed *above* the 10ma.

After making a 10-day intraday low yesterday SPY leaves an unfilled gap up today and closes above the open. It closes above the 10ma and above the 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
10	-16,709.63	13	5	8	38.46	1,441.12	-2,989.41	0.48	0.30	-1,285.36
9	-14,651.73	13	6	7	46.15	1,361.87	-3,260.42	0.42	0.36	-1,127.06
8	-9,235.63	13	7	6	53.85	1,144.65	-2,874.70	0.40	0.46	-710.43
7	-5,812.38	13	7	6	53.85	1,361.31	-2,556.93	0.53	0.62	-447.11
6	797.24	13	7	6	53.85	1,222.20	-1,293.03	0.95	1.10	61.33
5	-726.45	13	6	7	46.15	1,028.22	-985.11	1.04	0.89	-55.88
4	362.01	13	8	5	61.54	866.62	-1,314.20	0.66	1.06	27.85
3	-5,017.09	13	6	7	46.15	823.25	-1,422.37	0.58	0.50	-385.93
2	-5,573.48	13	5	8	38.46	776.58	-1,182.05	0.66	0.41	-428.73
1	-5,615.05	13	6	7	46.15	311.16	-1,068.86	0.29	0.25	-431.93

Most striking here versus the first test is that the win: loss ratio is flipped. Risk increases and the potential reward declines when the market is already short-term overbought.

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



The green Aggregator line is still well above 0. The positive value means the net expectation from the Active Studies List is for upside over the next few days. This is no surprise since all the active short-term studies are bullish. Meanwhile the black Differential line dropped sharply and is now negative. Readings below 0 mean the SPX has outperformed expectations over the last few days. So net expectations are for upside but the SPX has slightly outperformed recent expectations. This is considered a neutral configuration. It can be seen on the chart whenever both lines are on opposite sides of zero. Due to this the Aggregator System changed from long to flat at the close.

Based on the current active studies the green Aggregator line is set to remain above 0 on Monday. This could change should strong bearish evidence emerge. Meanwhile the Differential Pivot will be at 1,306.14. This is over 1% below Friday's close. So for the Differential line to rise back above 0 the SPX would need to give back all of Friday's gains on Monday.

The Aggregator is back to a neutral stance and I'm inclined to step aside until a better risk/reward setup emerges.

Intermediate-term Outlook (2 weeks – 2 months)– updated 2/28 - bullish

This week was the 1st in which the SPX failed to make a new high since November. Prior to this it had been 12 straight weeks of higher intraweek highs. I took a look at other times such streaks existed and what happened after they ended.

After making a higher high for at least 12 weeks in a row, SPX fails to do so this week.
Buy on close. Sell X weeks later. \$100/trade. 1961 - present.

X Weeks	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
13	13,100.76	5	5	0	100.00	2,620.15	0.00	100.00	100.00	2,620.15
12	9,579.51	5	4	1	80.00	2,640.27	-981.56	2.69	10.76	1,915.90
11	10,875.23	5	5	0	100.00	2,175.05	0.00	100.00	100.00	2,175.05
10	14,113.96	5	5	0	100.00	2,822.79	0.00	100.00	100.00	2,822.79
9	9,505.39	5	4	1	80.00	2,867.63	-1,965.12	1.46	5.84	1,901.08
8	7,833.41	5	3	2	60.00	3,794.92	-1,775.68	2.14	3.21	1,566.68
7	8,288.25	5	2	3	40.00	5,233.05	-725.95	7.21	4.81	1,657.65
6	2,747.41	5	2	3	40.00	3,065.90	-1,128.13	2.72	1.81	549.48
5	8,325.31	5	3	2	60.00	3,344.10	-853.50	3.92	5.88	1,665.06
4	6,536.42	5	3	2	60.00	2,990.58	-1,217.66	2.46	3.68	1,307.28
3	5,310.43	5	3	2	60.00	2,325.31	-832.75	2.79	4.19	1,062.09
2	537.56	5	1	4	20.00	1,644.98	-276.86	5.94	1.49	107.51
1	2,913.38	5	3	2	60.00	1,534.25	-844.69	1.82	2.72	582.68

The 5 instances were 11/5/65, 3/17/72, 1/8/93, 8/15/97, and 4/17/98.

I wouldn't try and draw too much from just 5 instances. Early indications suggest the market is not immune from a short-term pullback, but that past instances have not marked major tops. I decided to also loosen the criteria a bit and see how the results looked.

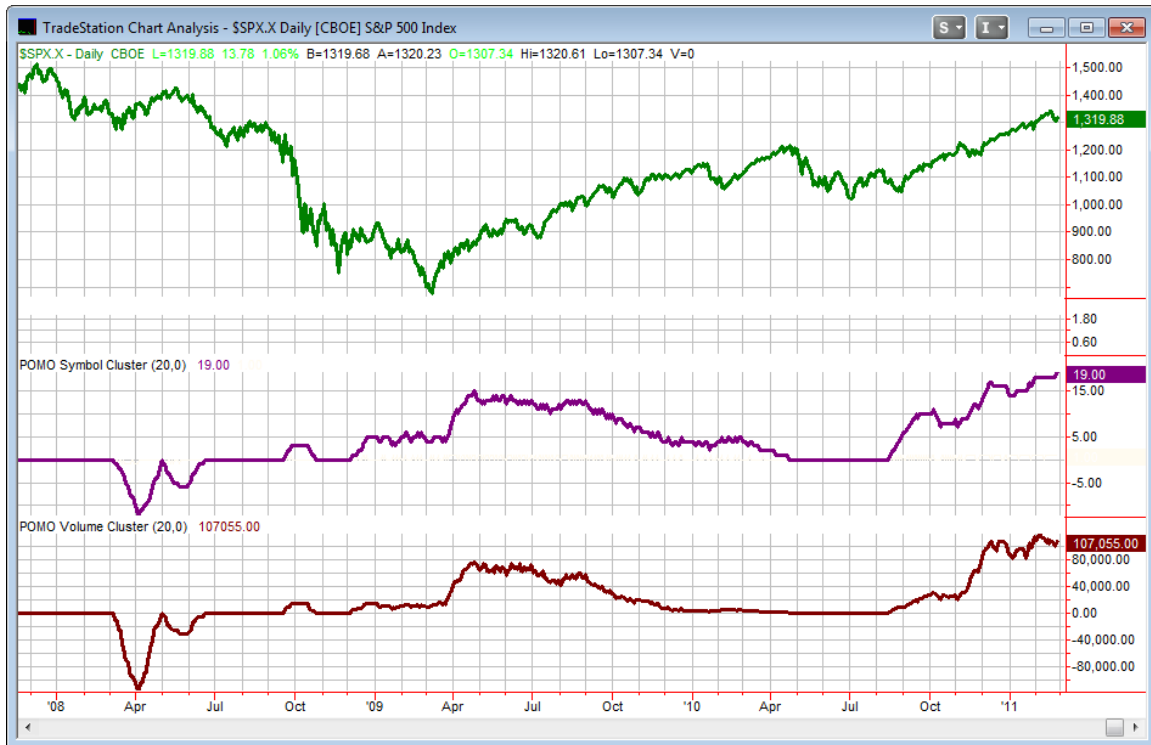
After making a higher high for at least 10 weeks in a row, SPX fails to do so this week. Buy on close. Sell X weeks later. \$100/trade. 1961 - present.										
X Weeks	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
13	67,421.97	13	12	1	92.31	5,938.01	-3,834.09	1.55	18.58	5,186.31
12	55,142.15	13	10	3	76.92	5,990.29	-1,586.92	3.77	12.58	4,241.70
11	61,513.42	13	11	2	84.62	5,613.39	-116.93	48.01	264.05	4,731.80
10	57,749.01	13	12	1	92.31	4,871.87	-713.40	6.83	81.95	4,442.23
9	47,972.48	13	10	3	76.92	5,126.18	-1,096.43	4.68	15.58	3,690.19
8	42,950.42	13	9	4	69.23	5,201.66	-966.13	5.38	12.11	3,303.88
7	35,810.03	13	8	5	61.54	5,151.16	-1,079.85	4.77	7.63	2,754.62
6	29,305.82	13	9	4	69.23	3,951.44	-1,564.28	2.53	5.68	2,254.29
5	30,275.76	13	10	3	76.92	3,391.07	-1,211.64	2.80	9.33	2,328.90
4	24,184.17	13	10	3	76.92	2,814.11	-1,318.98	2.13	7.11	1,860.32
3	18,712.83	13	10	3	76.92	2,094.60	-744.38	2.81	9.38	1,439.45
2	7,111.18	13	6	7	46.15	1,970.84	-673.41	2.93	2.51	547.01
1	13,005.40	13	11	2	84.62	1,335.89	-844.69	1.58	8.70	1,000.42

Inclinations don't appear much different based on this table.

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>



The POMO Days indicator hit a new high on Monday as 19 of the last 20 days have now seen POMO buying. The POMO Volume indicator is also still hovering near all-time highs. POMO activity is expected to remain strong as every one of the next 8 days is scheduled for buying according to the tentative operations schedule. This should continue to put a nice wind at the market's back.

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

Intermediate-term evidence continues to point higher. POMO, trend, momentum, and price patterns all suggest the rally is not over. While the market got a bit of a scare this past week it seems unlikely that this will mark the end of the rally. I still favor a bullish outlook. 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

GE – buy 1/3 @ \$20.37

HPQ – buy 1/3 @ \$43.59

HPQ – buy 1/3 @ \$42.17

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 3 (GE, HPQ-2)

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.

HPQ – buy 1/3 position @ \$42.17 limit (Still looking for a fill on this Catapult)

There is quite a bit more on the triggers page tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	2/24/2011	\$130.00	\$132.33	1.79%		Sell @ \$132.00 limit.
GE(1/3)	2/24/2011	\$20.12	\$20.82	3.48%		Catapult
HPQ (1/3)	2/24/2011	\$43.16	\$42.68	-1.11%		Catapult

I will look to take profits on the SPY trade idea. Should we gap lower I'll hold out for at least \$132.00. Should this not be achieved in the first ½ hour or so I may look to institute a stop below the intraday low. I will send out an intraday update if I elect to use a stop.

If GE hits \$21.04 intraday or closes \geq \$20.94 it will trigger an exit at Tuesday's open.

HPQ is not close to an exit currently.

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