

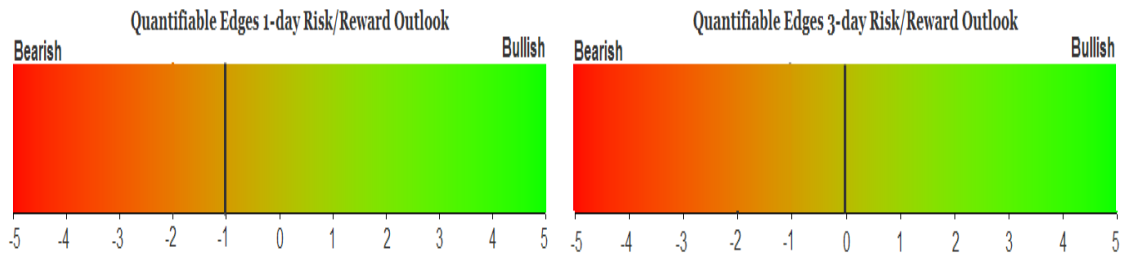
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 24, 2011

Volume 4 Issue 57

Market Overview



Tonight's Research Points

- When the VXO has been stretched more than 15% below its 10ma it has led to negative returns for the SPX.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook

The Bottom Line

Expectations are for mild upside but the market is slightly overbought. No strong edge yet. I'll continue to exercise patience.

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				
March 24, 2011	VIX 15% below 10ma	1 day	Bearish	
March 23, 2011	Lowest volume 20. Close >10&200ma	1-3 days	Bearish	-1.10%
March 23, 2011	VIX from 10% above to 10% below 10ma	1-8 days	Bullish	2.10%
March 21, 2011	2 up after 1.75% down. C>200ma	1-5 days	Bullish	2.30%
March 18, 2011	Sweet spot bounce	1-5 days	Bullish	3.10%
Active - Long Term				
March 22, 2011	3 Days Up Issues % > 70%	int term	Bullish	
November 22, 2010	High number of POMO Days recently	int term	Bullish	
October 25, 2010	SPX Golden Cross	int term	Bullish	
Dropped Tonight				
March 22, 2011	VIX drops 15%	1-2 days	Bearish	
March 22, 2011	3 Days Up Issues % > 70%	1-2 days	Bullish	
March 16, 2011	VIX 100-high. SPX no 100-low	1-6 days	Bullish	

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

The Evidence

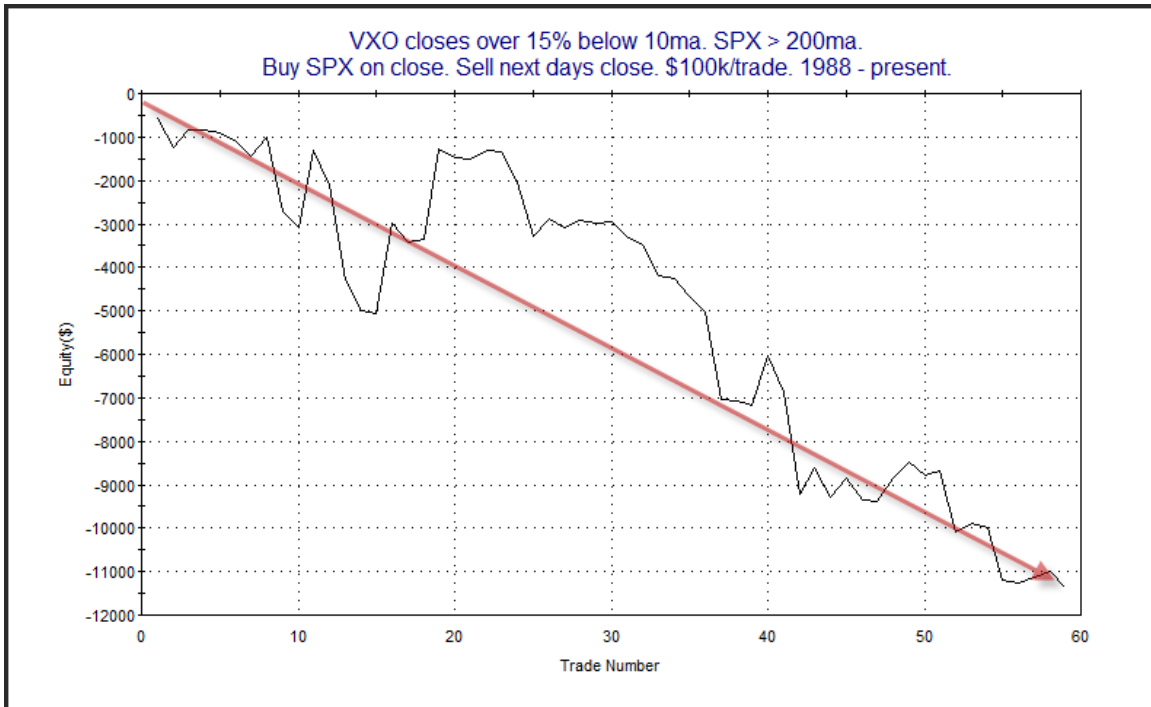
A gap lower to start the day was followed by morning selling. The market bottomed within the first hour though and spent most of the rest of the day working its way higher. In the end the major indices all posted moderate gains. The SPX and Russell 2000 both rose 0.3% while the NASDAQ tacked on 0.5%. Breadth was barely positive as the NYSE Up Issues % came in at 53% and the Up Volume % was 51%. Total NYSE volume rose from Tuesday's levels but was still below average.

The extreme action in volatility measures (i.e. VIX) we've been seeing over the last week or so has provided a good number of studies. Tonight is no exception. The Quantifinder identified a study from the 2/19/10 Subscriber Letter that looked at times the VXO had closed more than 15% below its 10ma. Even when the SPX is trading above its 200ma, stretches this extreme have shown short-term bearish implications. I examined that study a number of ways tonight. Previously I had shown results from the day the VXO crossed under its 15% stretch threshold up to five days out. I found much of the edge was thanks to day 1 action. I decided perhaps a better way to examine the edge would be to measure not just on the day it crossed below the threshold, but for every day in which it actually closed there. I found this gave a greater sample size and a steadier equity curve. Results of this approach are below.

VXO closes over 15% below 10ma. SPX > 200ma. Buy SPX on close. Sell next days close. \$100k/trade. 1988 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	(\$11,377.64)	Profit Factor	0.50
Gross Profit	\$11,316.38	Gross Loss	(\$22,694.02)
Total Number of Trades	59	Percent Profitable	32.20%
Winning Trades	19	Losing Trades	40
Even Trades	0		
Avg. Trade Net Profit	(\$192.84)	Ratio Avg. Win:Avg. Loss	1.05
Avg. Winning Trade	\$595.60	Avg. Losing Trade	(\$567.35)
Largest Winning Trade	\$2,096.10	Largest Losing Trade	(\$2,341.24)

Stats here suggest a fairly strong downside inclination. Last night's study suggested that the strength we had been seeing was likely to lead to more strength. We got a little more strength today, but the continued slide in the VXO has it so stretched that it now appears

overdone to the degree that a reversion becomes likely. To get a better idea of how this edge has played out over time, I have produced below an equity curve.



There has really only been one brief time period where the equity curve has risen substantially. That was between trades 15-20. Other than that there appears to be a fairly steady and consistent downside edge.

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



The green Aggregator line is still slightly 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 remains below 0. Readings below 0 mean the SPX has outperformed expectations over the last few days. So net expectations are for upside but the SPX is relatively overbought. This is considered a neutral configuration. It can be seen on the Aggregator chart whenever the Aggregator and Differential lines are on opposite sides of 0. Due to this the Aggregator System remained flat at the close.

Based on the current active studies the green Aggregator line is set to stay above 0 on Thursday. This could change should more bearish evidence emerge. Meanwhile, the Differential Pivot will be 1,305.76. This is about 0.6% above Wednesday's close. In other words, unless the SPX rises at least this much, the Differential Line is going to flip to positive, signaling underperformance versus expectations rather than the recent outperformance. There, unless compelling bearish evidence emerges or the market puts in a strong move higher the Aggregator System is likely to trigger long.

It is also notable that while expectations are positive over the 3-day period, 1-day expectations are slightly negative. This is reflected in the 1-day Risk/Reward graphic at the top of the letter. Should those negative expectations play out tomorrow, it could provide a nice entry point for a long-side trade. I am not going to enter anything as a trade idea at this point, though. The number of studies is scheduled to drop off quickly over the next couple of days and the Aggregator could go either way depending on how action unfolds. Therefore, I am going to stand aside one more day. Should the

Aggregator System provide a signal on Thursday afternoon, I will likely look to take a position on Friday morning.

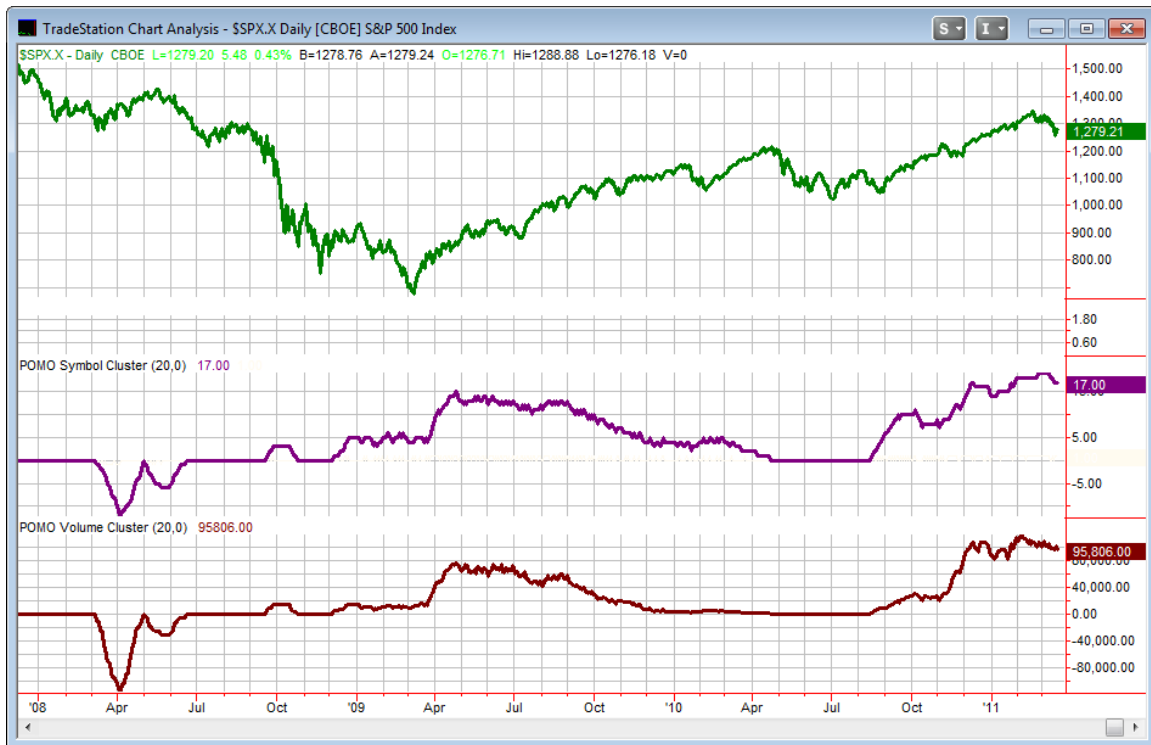
Intermediate-term Outlook (2 weeks – 2 months)– updated 3/21 – slightly bullish

It's now been about a month since the market peaked. And while it's still a good ways above its 200ma, it also just made 50-day lows. So it seems to be a bit of an intermediate-term downtrend, but still in a larger uptrend. The selloff, which under more "normal" circumstances may have been less severe, has likely been exacerbated by foreign news about an earthquake, a tsunami, a possible nuclear meltdown, and a Middle East war. That is a lot to contend with. So the question now is whether these events may have helped to kick off a more substantial move south, or whether they just made what may have been a short-term pullback more severe. If this is the case, the market may stand a decent chance to right itself and reassume its uptrend.

One factor arguing for the bullish case would be the Fed's current POMO activity. 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 is still extremely elevated at 17. According to the tentative operations schedule every day this upcoming week POMO buying is planned. It doesn't appear as if either of the POMO Days or POMO Volume indicators are likely to decline. I expect POMO to continue to provide a steady wind at the market's back. For those that would like to view the upcoming schedule I have provided a link below.

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

Though I looked at quite a number of concepts this week, I did not unearth anything terribly compelling for either the bull or bear case from an intermediate-term standpoint. I'm still inclined to slightly favor the bullish side. I suspect the next few days may tell us a lot about whether this bounce is likely to succeed or fail. From my standpoint this simply means I'll be a bit more conservative with bearish setups than bullish ones.

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

None.

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