

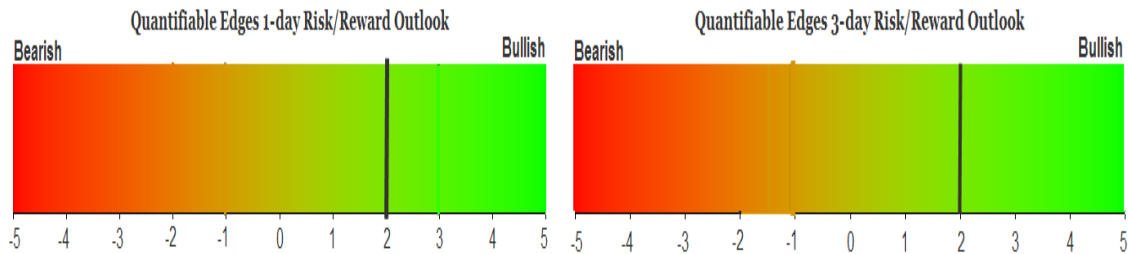
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 19, 2011

Volume 4 Issue 96

Market Overview



Tonight's Research Points

- Back to the middle of the range, the upside edge is now somewhat reduced.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is long.

Short-term Outlook

The Bottom Line

The market put in a nice bounce today. Now mid-range there is no new and compelling evidence availing itself. Thursday's Differential Pivot is actually below Wednesday's closing price, which means it will take a strong selloff to avoid seeing an exit trigger. This has me in "profit-taking" mode.

Summary of Recent Active Studies (see Letters from listed dates for details)

Study Date	Description	Time span	Bias	Avg Max Move
Active				
May 18, 2011	SPY gap down and partial reverse up.	1-5 days	Bullish	1.90%
May 12, 2011	SPX dn 1%. Decliners 2x advancers	1-9 days	Bullish	3.05%
May 11, 2011	SPX dn 4 then Up 3. Close < 7 days ago.	1-10 days	Bullish	3.10%
Active - Long Term				
May 2, 2011	SPY up 3 days all lower volume	1-19 days	Bearish	
April 25, 2011	Nas/SPX relative strength favors Nas	int term	Bullish	
March 22, 2011	3 Days Up Issues % > 70%	int term	Bullish	19.00%
November 22, 2010	High number of POMO Days recently	int term	Bullish	
October 25, 2010	SPX Golden Cross	int term	Bullish	
Dropped Tonight				
May 13, 2011	SPY gap down and reverse up.	1-4 days	Bullish	1.90%

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

The Evidence

Bullish tendencies prevailed on Wednesday and the market put in some nice gains. The SPX rose 0.9%, the Nasdaq was up 1.1%, and the Russell 2000 gained 1.6%. Breadth was nicely positive as the NYSE Up Issues % came in at 76.5% and the Up Volume % was 78%. The rise didn't come on strong volume, though. The NYSE volume was the lowest in over a week.

While today's move may not have seemed to be extremely strong, it was strong relative to the market's recent trading range. It's fairly unusual for the SPY to close at a 10-day low one day, and then in the upper half of its 10-day range the next. I ran the test below to examine all instances of this happening when the market was trading above its 200ma.

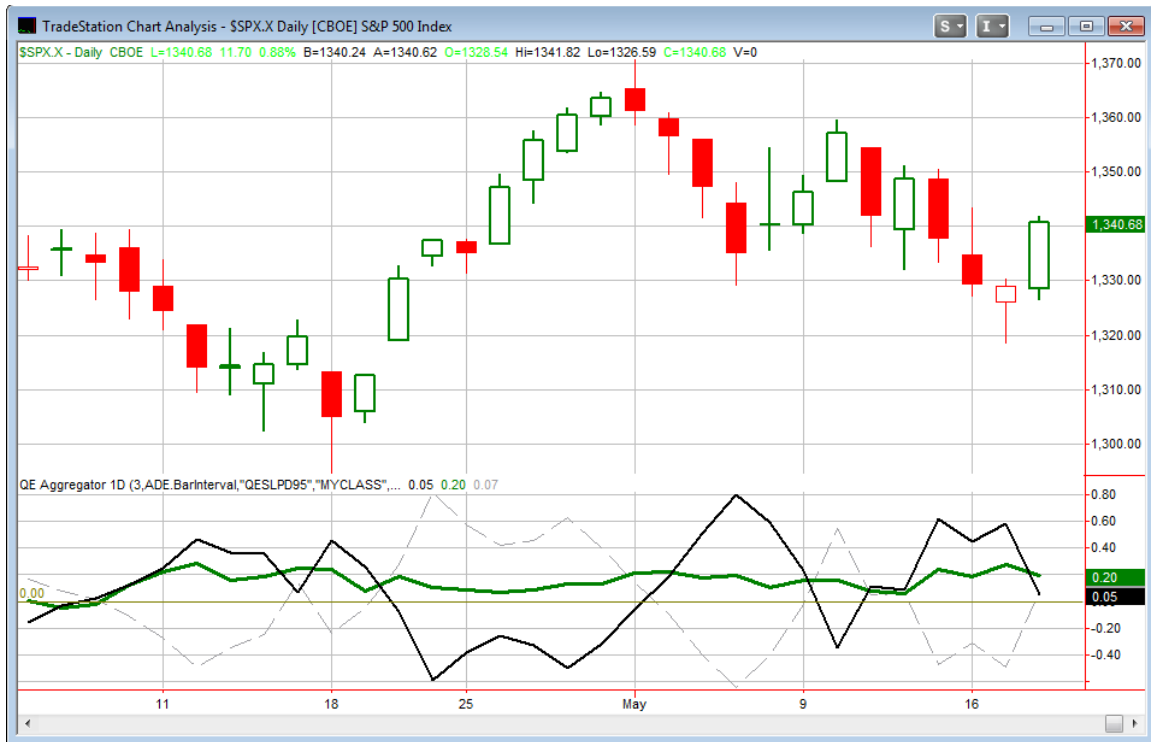
Yesterday SPY closed at a 10-day low. Today it closed in the upper half of its 10-day range. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1993 - present.										
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	5,485.65	30	16	14	53.33	2,088.29	-1,994.79	1.05	1.20	182.86
9	8,085.36	31	16	14	51.61	2,121.34	-1,846.87	1.15	1.31	260.82
8	-1,648.92	31	16	15	51.61	2,075.24	-2,323.51	0.89	0.95	-53.19
7	-1,539.05	31	15	16	48.39	2,379.61	-2,327.08	1.02	0.96	-49.65
6	1,096.02	31	15	16	48.39	2,300.61	-2,088.32	1.10	1.03	35.36
5	4,463.89	31	16	15	51.61	1,905.96	-1,735.43	1.10	1.17	144.00
4	2,567.03	31	16	15	51.61	1,786.79	-1,734.77	1.03	1.10	82.81
3	1,733.62	31	17	14	54.84	1,331.55	-1,493.06	0.89	1.08	55.92
2	378.95	31	18	13	58.06	1,081.97	-1,468.96	0.74	1.02	12.22
1	3,890.21	31	16	15	51.61	869.76	-668.40	1.30	1.39	125.49

Results don't get much more neutral than this. I also tried using a close above the 10ma rather than the 10-day range. That didn't offer compelling evidence either.

I often remark that edges are dull in the middle of a trading range and we are seeing another example of that here. There were also no compelling studies offered by the Quantifinder tonight.

Of course there are a number of studies still active from the last few nights, and they are all looking for further upside.

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



The green Aggregator Line dipped just slightly tonight. It remains strongly 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 took a sizable dive as the SPX rose on Wednesday. The SPX came just 2 points shy of moving the Differential Line into negative territory. So though it is much lower, the Differential Line is still positive. Readings above 0 mean the SPX has underperformed expectations over the last few days. So net expectations are for upside and the SPX is slightly oversold versus recent expectations. Historically this combination has provided an upside edge. It can be seen on the chart whenever both lines close above 0. Due to this the Aggregator System remained long at the close.

Without any short-term bearish studies on the Active List the green Aggregator line is again set to close above 0 on Thursday. This could change if strong bearish evidence emerges. Meanwhile, the Differential Pivot will be just 1,335.86. This is about 0.4% *below* Wednesday's close. This means that the Differential Line will drop into negative territory unless the SPX sells off at least this much.

Occasionally we will see the aggregator and differential set up in the same way we are seeing tonight. The SPX didn't move far enough in our direction today to flip the

differential line and trigger an exit, but an exit would be triggered if it closed at the same level tomorrow. When this happens, it leads me to consider how I want to exit the trade. Under most circumstances I try and ride aggregator trades until the end of the day and exit them at the close. One reason I do this because the exit signal isn't official until the market close. I also do it because if the market is moving in the direction I anticipate during the day I want to be able to capture as much of that as possible. If a "trend day" emerges I don't want to miss out on a big part of the move by taking a quick exit.

But tomorrow is somewhat different than a typical exit day. It's not going to take a strong move higher or a trend day in order to trigger an exit. And exit could be triggered even with a move lower. This makes an early exit a bit more appealing. Trailing a stop is one option if the market begins to trend higher tomorrow. Another might be to sell into early-morning strength. If there is a sizable gap up to start the day then I would be inclined to take partial profits near the open. The chances of a strong trend day emerging tomorrow appear greatly reduced. There are two reasons I say this. First, trend days are less common in the middle of a trading range. A strong move from a low point is much more likely as bottom pickers and scared shorts continually push the market higher. Trend days can also emerge from fresh breakouts since they often generate excitement. Breakout traders rush to buy and shorts rush to cover as obvious resistance levels are broken. Second, large range days are more often followed by narrow range, or consolidation days, than they are another large range day.

Since the chance of a strong trend day appears unlikely I'm anticipating a range-day. The logical thing to do if you are anticipating a somewhat range-bound market is to take some profits at the upper end of the anticipated range. This is easier said than done, but I have detailed in the trade ideas section below my exit parameters Thursday.

Intermediate-term Outlook (2 weeks – 2 months)– updated 5/16 – moderately bullish

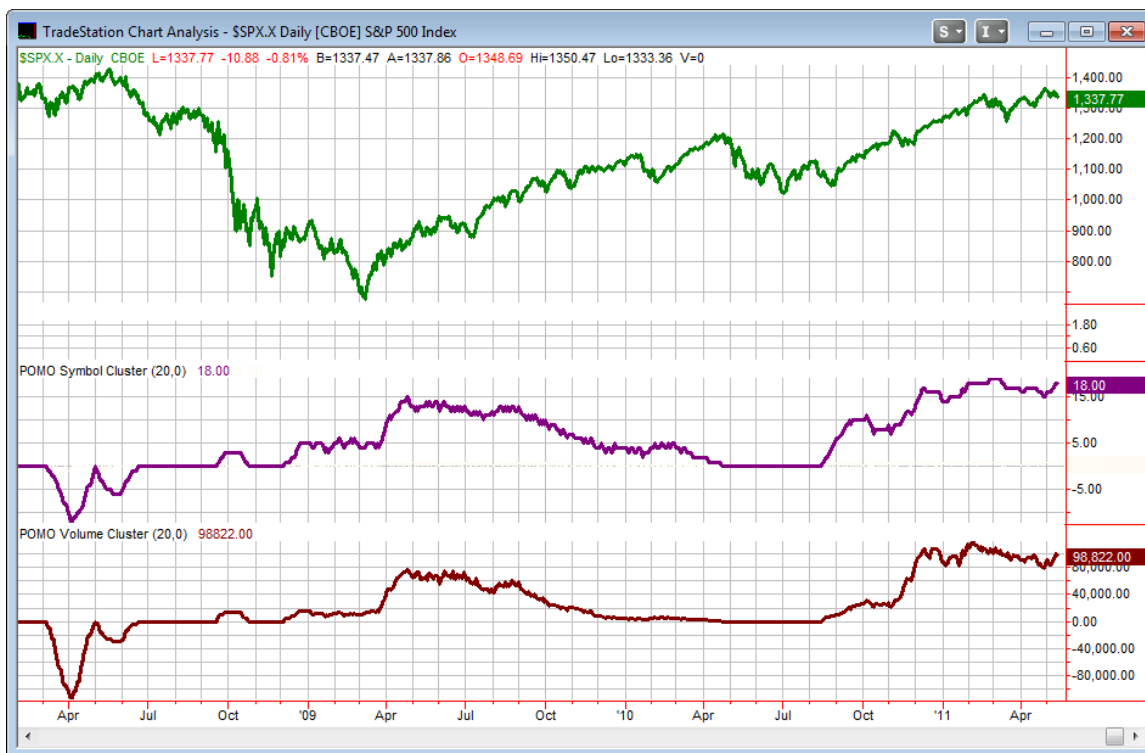
After spending most of the week in positive territory, Friday's action left the market down slightly for the week. Nothing new appeared in the way of intermediate-term studies. The big news was the release of the new POMO schedule which happened on Wednesday afternoon.

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>



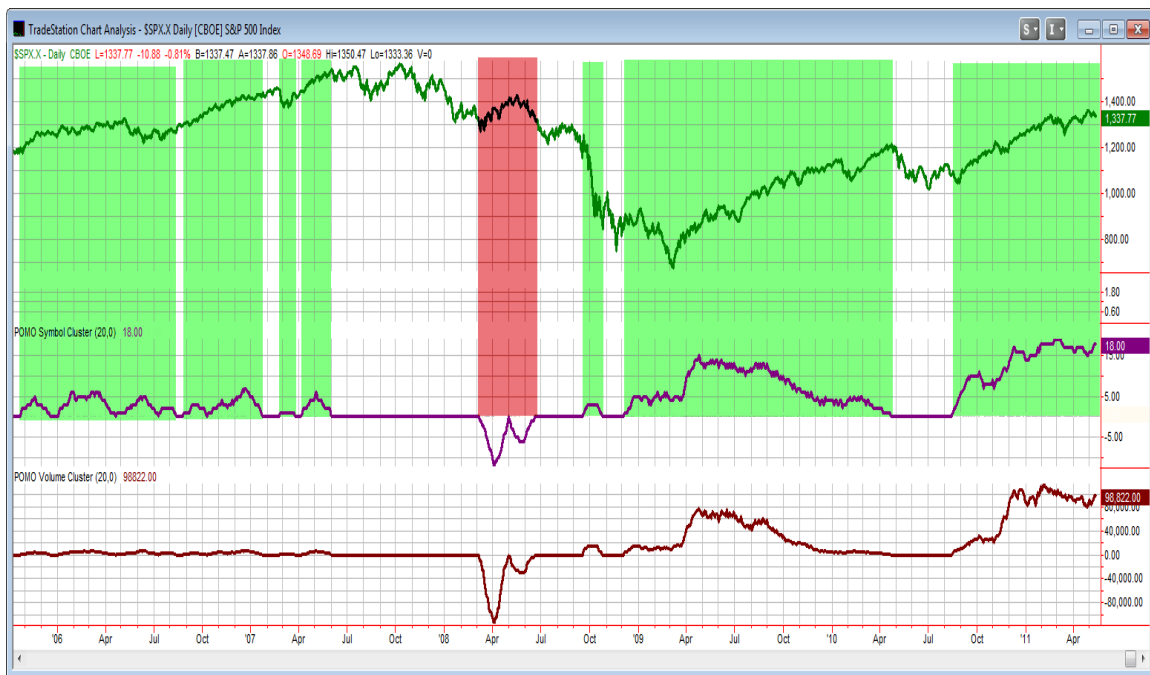
Both the POMO Days and POMO Volume indicators rose a bit this past week. This is no surprise since there was sizable buying that occurred every day. The schedule that was released on Wednesday calls for POMO this whole next week. In fact the next day without POMO buying scheduled is May 27th – the day before Memorial Day weekend.

But the new POMO schedule isn't only strong through May. It shows substantial buying also into June. Between May 12th and June 9th there are 18 days of POMO buying scheduled. And though the buying is expected to end in June, it is now clear that it isn't going to happen early in the month. We'll have to wait until the next schedule is released on June 10th to see when the end of QE2 will be.

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

The persistent part of this bull move seems to be over. Since February it has been a choppy struggle to post any new highs. Intermediate-term indications still appear to favor the bulls and new highs still seem more likely than an immediate correction. Still, I'm beginning to feel a bit more cautious. Positive seasonality typically goes out during May and with the end of QE2 looming, reduced liquidity could have a negative impact. The POMO chart below is a long-term version of the one I showed above. The green shaded areas are times where there was some pumping over the last 20-day period. The pinkish-red shading marks the period where the Fed was selling treasuries instead of buying them. The white areas marked the times where there was no POMO activity over the previous 20 days. POMO buying didn't always seem to take effect immediately, but periods without that buying were generally dismal. The 2 lengthy periods where the POMO indicators were at 0 or below lasted from 6/1/07 through 9/19/08 (SPX lost 18.3%) and from 4/22/10 through 8/17/10 (SPX lost 9.6%).



So it is a bit early to turn bearish, and I still think this rally has some legs, but I'm no longer as gun-ho as I've been. I'll likely begin taking a bit more caution with long trades. Perhaps scaling in slower or managing positions a little tighter. I still favor the long-side over the short-side, but not as clearly.

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)	5/12/2011	\$134.09	\$134.36	0.20%		Aggregator
SPY(1/4)	5/17/2011	\$132.69	\$134.36	1.26%		Aggregator

SPY – sell 1 lot @ \$134.86 ON OPEN. If not filled on open cancel order and reset to a \$135.25 limit. If SPY gaps up at least \$0.50, I'll take the gift and exit. Otherwise I'll look to exit just below the 5/12 and 5/13 highs.

If the market consolidates above the Differential Pivot and then begins to trend higher, I will likely look to trail a stop on 1 or both lots and will send gold subscribers intraday updates should I elect to trail a stop.

If targets are not hit by the end of the day I will sell at least 1 lot on any SPX close above the Differential Pivot. Should I decide to sell more than 1 I will send an intraday update.

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