

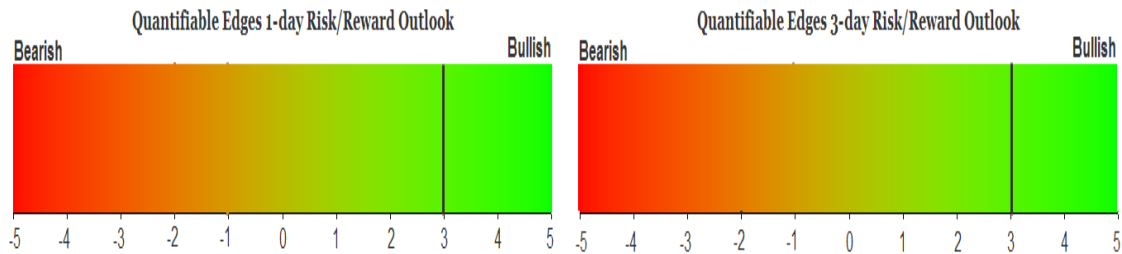
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 26, 2011

Volume 4 Issue 101

Market Overview



Tonight's Research Points

- The reversal from a 20-day low in a long-term uptrend suggests further upside.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is long.

Short-term Outlook

The Bottom Line

The edge still appears to be to the upside. I am long looking to take advantage of it. I am not looking to add further tomorrow.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
May 24, 2011	SPX dn 1%. Decliners 2x advancers	1-9 days	Bullish	3.05%
May 24, 2011	20-day low & > 200ma. Big drop in 10.	1-7 days	Bullish	2.35%
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 24, 2011	2 down & 5-low on Mon. Close > 20	1 day	Bearish	
May 11, 2011	SPX dn 4 then Up 3. Close < 7 days ago.	1-10 days	Bullish	3.10%
May 18, 2011	SPY gap down and partial reverse up.	1-5 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

After a threatening-looking dip in the futures overnight, the market only opened marginally lower. It didn't stay negative for very long, either. Gains were looking fairly strong with about 45 minutes to go, but late selling toned down the final numbers. In the end the SPX gained 0.3%, the Nasdaq was up 0.6%, and the Russell 2000 rallied 1.3%. Breadth was moderately positive as the NYSE Up Issues % came in at 65% and the Up Volume % was 58%. Total NYSE volume rose a bit.

So we finally got a bounce today, but it wasn't too impressive looking. One thing it did have going for it was that it penetrated recent lows and then came back to finish higher on the day. Reversal patterns similar to what we saw today are often followed by further gains. Two studies that examined reversals from lows came from the March 14, 2011 Subscriber Letter. I have updated them below.

The first one looked at reversals from 20-day lows in a long-term uptrend.

SPY closed at a 20-day low yesterday. Today posts an outside day then closes up on the day and > 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	
6	8,791.34	7	6	1	85.71	1,605.29	-840.40	1.91	11.46	1,255.91	
5	5,756.16	7	6	1	85.71	1,351.55	-2,353.12	0.57	3.45	822.31	
4	3,318.64	7	5	2	71.43	1,163.42	-1,249.23	0.93	2.33	474.09	
3	1,787.88	7	6	1	85.71	891.35	-3,560.24	0.25	1.50	255.41	
2	2,100.07	7	6	1	85.71	640.33	-1,741.92	0.37	2.21	300.01	
1	181.81	7	2	5	28.57	1,189.63	-439.49	2.71	1.08	25.97	

The 3/13/11 instance was the lone loser. The consistent returns are impressive, but instances are very low. As I did last time, I also loosened the requirement and only required a 10-day low instead of a 20-day low.

SPY closed at a 10-day low yesterday. Today posts an outside day then closes up on the day and > 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	17,990.43	13	12	1	92.31	2,474.22	-11,700.18	0.21	2.54	1,383.88
9	20,900.99	13	11	2	84.62	2,389.28	-2,690.56	0.89	4.88	1,607.77
8	22,550.71	13	10	3	76.92	2,779.88	-1,749.38	1.59	5.30	1,734.67
7	24,065.09	13	11	2	84.62	2,332.50	-796.22	2.93	16.11	1,851.16
6	23,125.66	13	11	2	84.62	2,320.70	-1,201.04	1.93	10.63	1,778.90
5	19,614.83	13	11	2	84.62	2,160.26	-2,074.04	1.04	5.73	1,508.83
4	15,797.82	13	10	3	76.92	1,990.98	-1,370.66	1.45	4.84	1,215.22
3	8,851.14	13	10	3	76.92	1,492.96	-2,026.16	0.74	2.46	680.86
2	7,212.23	13	10	3	76.92	1,240.15	-1,729.74	0.72	2.39	554.79
1	4,330.16	13	4	9	30.77	1,986.65	-401.82	4.94	2.20	333.09

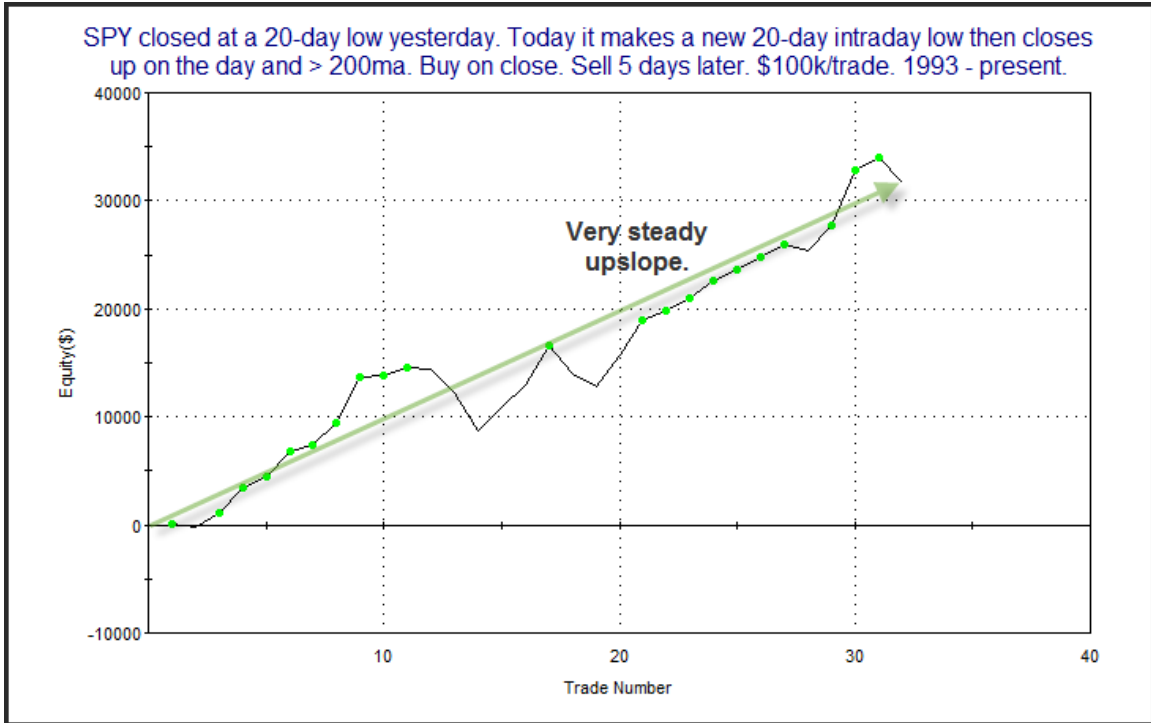
We see here similar results, but only a few more instances. So tonight I also decided to see what would happen if I loosened requirements of the 1st test in a different way. Rather than requiring an outside day, I simply required a lower low and a positive close.

SPY closed at a 20-day low yesterday. Today it makes a new 20-day intraday low then closes up on the day and > 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	44,016.20	29	23	6	79.31	2,278.19	-1,397.02	1.63	6.25	1,517.80
9	39,363.86	30	22	8	73.33	2,438.36	-1,785.02	1.37	3.76	1,312.13
8	29,798.31	31	21	10	67.74	2,443.48	-2,151.49	1.14	2.39	961.24
7	36,771.93	32	22	10	68.75	2,422.59	-1,652.50	1.47	3.23	1,149.12
6	33,964.15	32	23	9	71.88	2,231.89	-1,929.91	1.16	2.96	1,061.38
5	31,712.22	32	24	8	75.00	1,858.24	-1,610.69	1.15	3.46	991.01
4	25,560.75	32	22	10	68.75	1,684.57	-1,149.99	1.46	3.22	798.77
3	8,975.60	34	19	15	55.88	1,306.25	-1,056.21	1.24	1.57	263.99
2	13,885.71	36	23	13	63.89	1,351.74	-1,323.42	1.02	1.81	385.71
1	3,407.78	36	20	16	55.56	869.75	-874.21	0.99	1.24	94.66

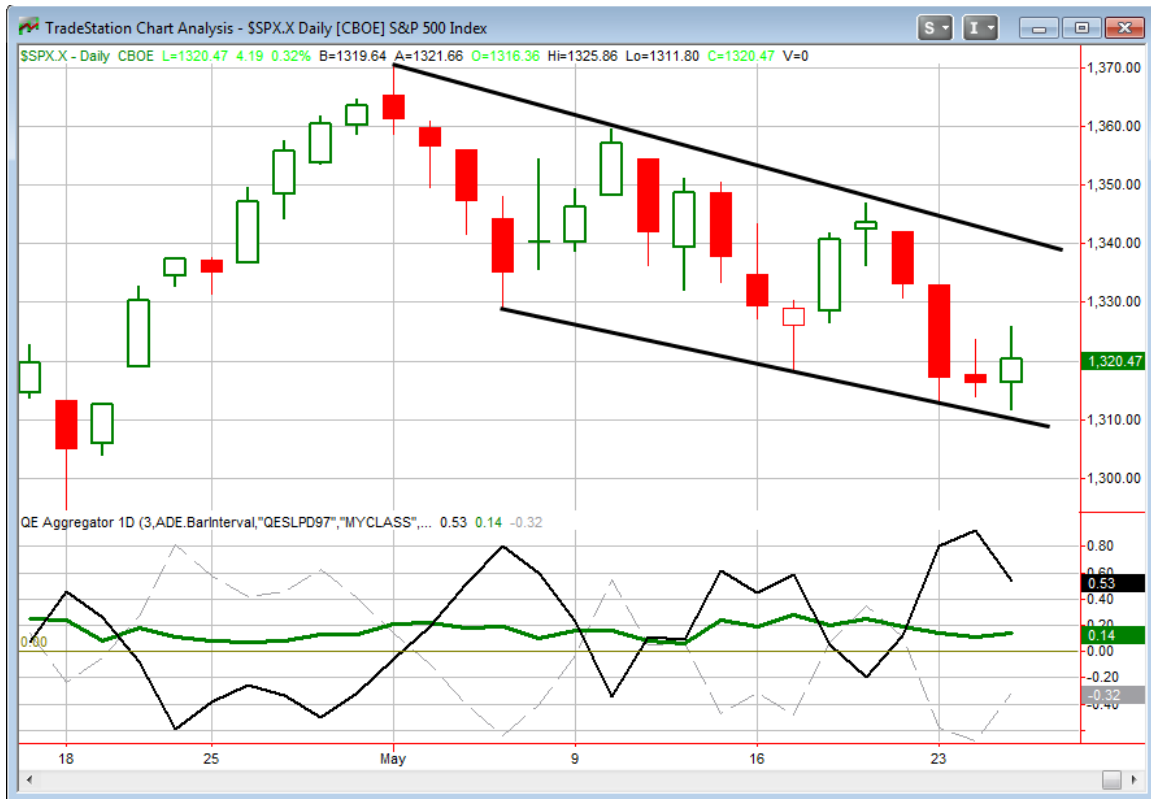
88% of instances posted a close above the entry price at some point in the next week.

By eliminating the need for a higher high, we finally get a solid sample size. And results continue to suggest a worthwhile upside edge. Below is an equity curve using a 5-day exit strategy.



The consistent returns make the equity curve appealing and provide me greater confidence in the results.

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



The green Aggregator Line remained well above 0 again tonight. 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 also remains strongly 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 strongly oversold versus recent expectations. Historically this configuration has suggested 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.

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 1,325.12. This is about 0.35% above Wednesday's close. So it would take a rally of at least this much to flip the Differential line back to negative.

I've probably been too conservative with my position sizing this week, but the intermediate-term trend is in some doubt and short-term bullish evidence has been solid but not great. I'm not planning on adding more exposure Thursday. If the bounce continues and turns the Differential Line negative, then I will look to take profits. If it rolls over then I will evaluate the evidence again tomorrow night and consider whether I should add more exposure at that time.

Intermediate-term Outlook (2 weeks – 2 months)– updated 5/23 – moderately bullish

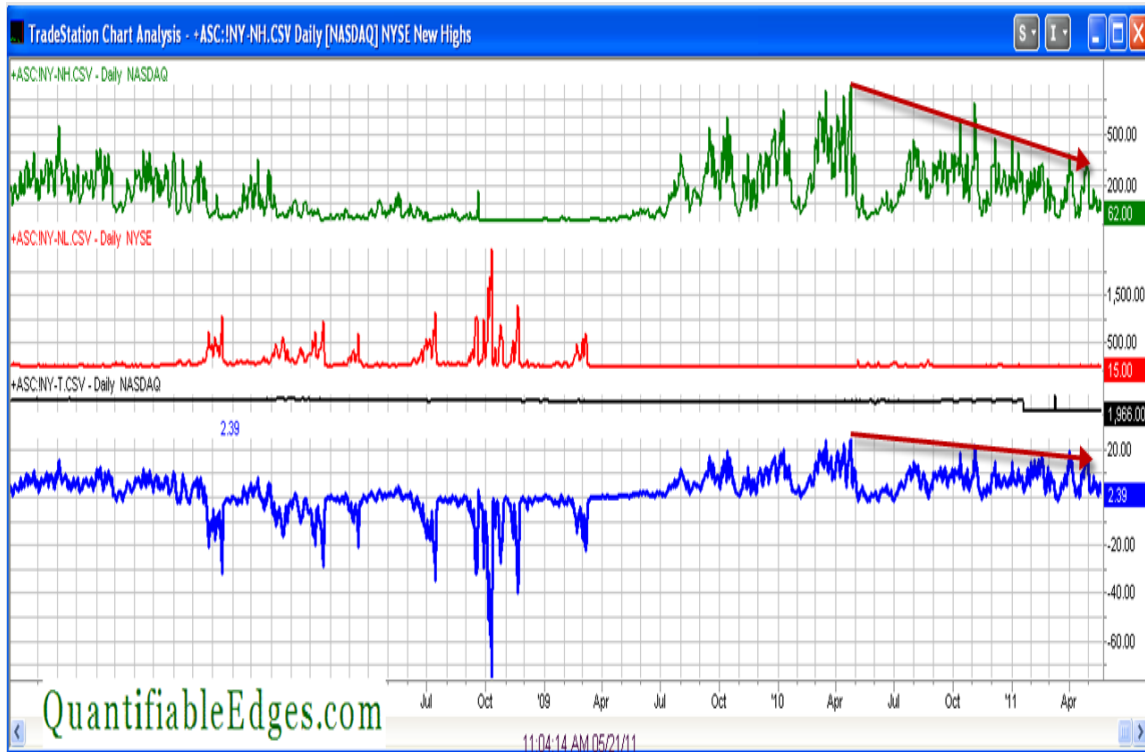
Friday's move down meant the recent upswing just posted a lower high. This is the second lower swing high we've had since the 5/2 peak. The first was on 5/10 and now the second can be seen on 5/19. We've also seen a lower low made during that time. The 5/17 low was below the 5/5 low. So it appears we are now seeing the market make a series of lower highs and lower lows. There is a word for a series of lower highs and lower lows - downtrend. A move below the 5/17 low would make it obvious. That would also take it below its 50-day moving average.

So are we seeing a mini move down, or is this the start of something big?

Breadth can often provide clues about impending tops. Major tops almost always see a divergence of breadth before prices begin to turn down. I published a study along with a number of detailed charts in the 10/12/09 subscriber letter. Readers who are interested in reviewing that may use the link below to access it.

[2009-10-12 QE Subscriber Letter.pdf](#)

In that study I looked at two measures of breadth. One was the advance/decline line and the other was the percentage of stocks hitting new highs. There is no divergence in the advance decline line at this point. It made a new high just recently on 5/10. There is a divergence in the number of new highs, and it's a divergence that has been in place for a little over a year now. The chart below is the long-term new highs and new lows chart from the charts page. You can clearly see how the number of new highs in the top pane, and the net percentage in the bottom pane, have both been trending lower since around April 2010.

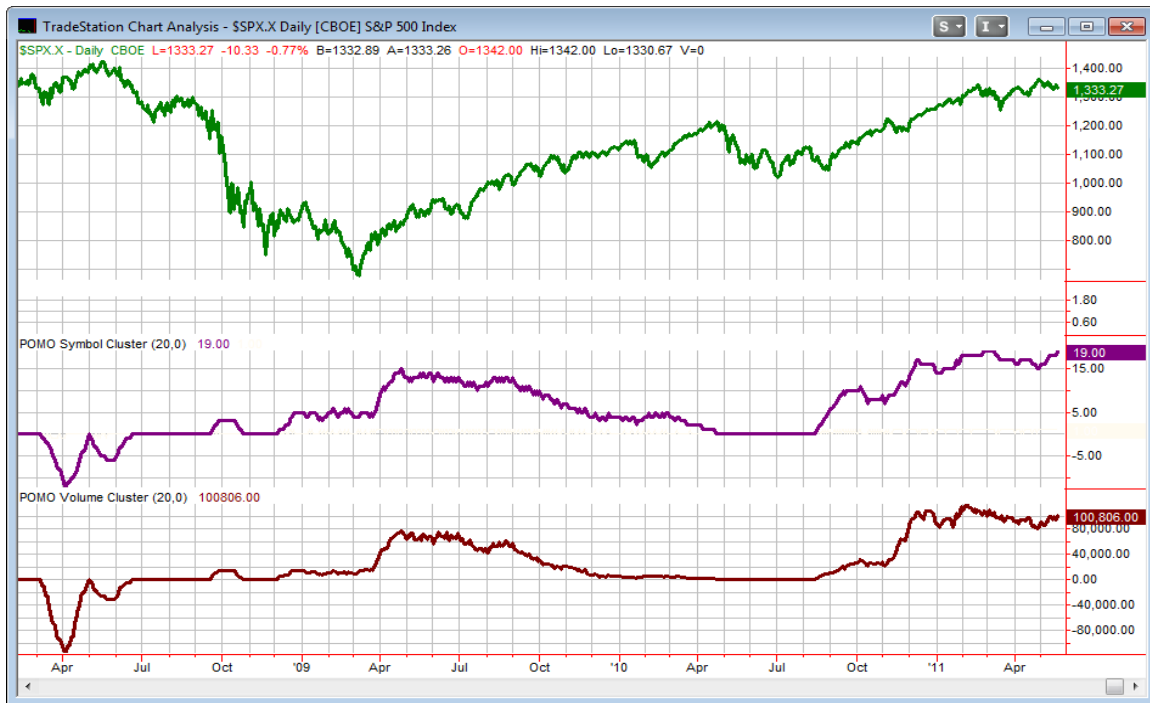


So between the advance/decline line and the decline in new highs breath is somewhat inconclusive. It doesn't appear to be suggesting a significant top is likely, but it does leave open the possibility.

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>



With buying occurring every day this past week both the POMO Days and POMO Volume indicators rose a bit. The liquidity pump continues to inject massive amounts of money into the system and to this point such action has acted as a strong positive influence on the market. Further buying is scheduled to take place Monday-Thursday this week. Friday is an off-day ahead of the long weekend.

For those that would like to view the upcoming schedule through June 10th I have provided a link below.

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

The market action has become substantially more choppy than it was a few months ago. We appear to be in a short-term downtrend over the last 3 weeks. Whether it turns into something more is unclear at this point. There is currently more evidence supporting new highs than there is suggested a prolonged downtrend. As usual, I'm willing to trade either side if a strong risk/reward opportunity presents itself. I'll continue to prefer long trades, but have already begun taking them with a bit less aggression.

Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

Open Catapult Triggers

GS – 1/3 position @ \$134.99 limit

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 1(GS)

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.

None tonight, though there are several listed on the triggers page that aggressive traders could look to.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	5/23/2011	\$131.98	\$132.39	0.31%		Aggregator
GS(1/3)	5/23/2011	\$133.64	\$136.24	1.95%		Catapult

I will exit the SPY position tomorrow should the SPX close \geq 1,325.12.

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