

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 27, 2011

Volume 4 Issue 102

Market Overview



Tonight's Research Points

- Volume was low, but that isn't necessarily a bad thing
- Next week is seasonally bullish.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is long.

Short-term Outlook

The Bottom Line

The studies are suggesting further upside, but the SPX is no longer oversold versus expectations. My index position is flat for now. I do have some money in Catapults (long).

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

| Study Date | Description | Time span | Bias | Avg Max Move |
|---------------------------|---------------------------------------|-----------|----------------|--------------|
| Active | | | | |
| May 26, 2011 | Reversal from 20-day low | 1-6 days | Bullish | 3.05% |
| 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 | |

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

The Evidence

After a shaky open the market put in a strong afternoon. In the end the SPX gained 0.4%, the Nasdaq was up 0.8% and the Russell 2000 rose 1.2%. Breadth was also strong as the NYSE Up Issue % came in at 69% and the Up Volume % was 74%. Total NYSE volume came in very light – perhaps in part due to the upcoming long weekend.

Most noted by the Quantifinder was the fact that the volume came in low. Since we are going in to a long weekend tomorrow I'm not terribly concerned about this. Still, below is an excerpt from the 5/10/11 Subscriber Letter. The studies discussed triggered again tonight. I have not bothered to update the results.

There was one volume-related study that appeared in the Quantifinder tonight. It looked at NYSE volume 2-week lows occurring on SPX up days and was last published in the 2/2/10 Subscriber Letter. While, I was a little hesitant to worry much about volume today I decided to take a closer look. But rather than just rerun the old test I decided to include a 200ma filter. Those updated results are below.

| SPX closes higher on lightest NYSE volume in 10 days. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1999 - 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 | -4,313.40 | 105 | 56 | 49 | 53.33 | 1,481.48 | -1,781.15 | 0.83 | 0.95 | -41.08 |
| 4 | 1,594.21 | 109 | 58 | 51 | 53.21 | 1,284.16 | -1,429.16 | 0.90 | 1.02 | 14.63 |
| 3 | -15,383.13 | 115 | 61 | 54 | 53.04 | 1,053.87 | -1,475.36 | 0.71 | 0.81 | -133.77 |
| 2 | -7,245.92 | 121 | 60 | 61 | 49.59 | 881.57 | -985.91 | 0.89 | 0.88 | -59.88 |
| 1 | -7,509.89 | 137 | 69 | 68 | 50.36 | 580.08 | -699.05 | 0.83 | 0.84 | -54.82 |

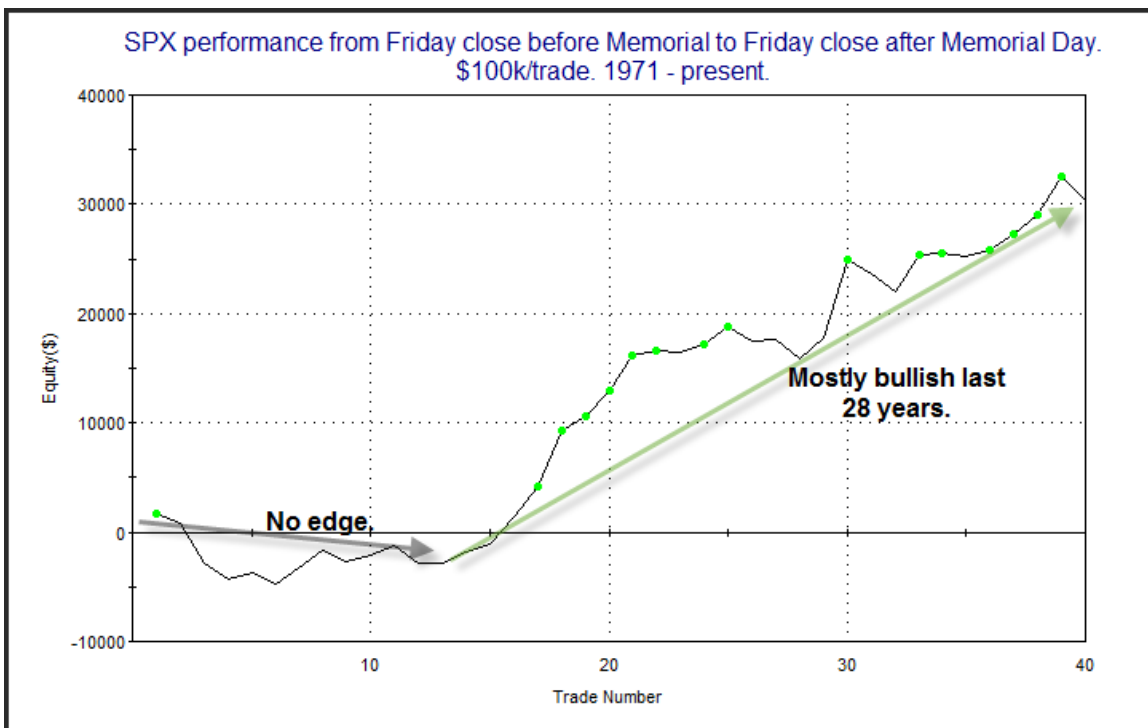
The original study showed what appeared to be a mild downside edge. These results are even less compelling. There still may be a downside edge, but it is hardly strong enough to make it worth pursuing. But what if I also require that yesterday saw the SPX close up as well?

SPX closes higher on lightest NYSE volume in 10 days. It also closed higher yesterday.
Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1999 - 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 | 13,163.21 | 60 | 35 | 25 | 58.33 | 1,367.10 | -1,387.41 | 0.99 | 1.38 | 219.39 |
| 4 | 10,501.08 | 60 | 36 | 24 | 60.00 | 1,125.64 | -1,250.91 | 0.90 | 1.35 | 175.02 |
| 3 | 9,866.41 | 60 | 38 | 22 | 63.33 | 1,016.22 | -1,306.82 | 0.78 | 1.34 | 164.44 |
| 2 | -655.59 | 64 | 34 | 30 | 53.13 | 916.01 | -1,060.00 | 0.86 | 0.98 | -10.24 |
| 1 | -232.72 | 74 | 38 | 36 | 51.35 | 540.78 | -577.29 | 0.94 | 0.99 | -3.14 |

What once appeared to potentially suggest a downside edge, no longer appears to suggest anything.

There are also some seasonal tendencies that will be kicking in here soon. Next week is Memorial Day. The week of Memorial Day has frequently been a good one for the market, and the most positive day of the shortened week has been Friday. I discussed all this in the 6/1/10 Subscriber Letter. I'll get into the Friday after Memorial Day inclination in more detail over the weekend. For now let's have a look at next week as a whole. The chart below is updated from the 6/1/10 letter.



There was no substantial edge apparent throughout the 70s, but starting in 1983 you'll note a strong bullish tendency. Below are some performance statistics for the '83 – present timeframe.

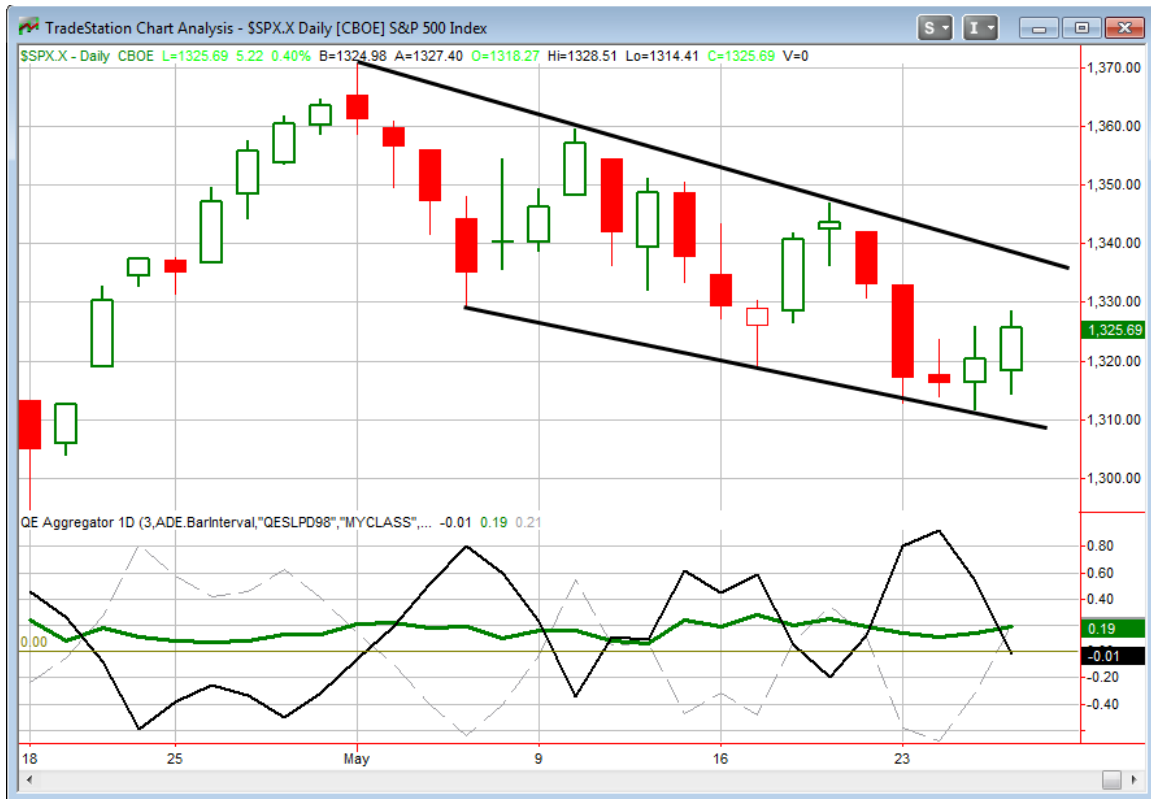
| SPX performance from Friday close before Memorial to Friday close after Memorial Day. \$100k/trade. 1983 - present. | | | |
|--|-------------|--------------------------|--------------|
| TradeStation Performance Summary | | | Collapse ^ |
| All Trades | | | |
| Total Net Profit | \$33,155.22 | Profit Factor | 4.88 |
| Gross Profit | \$41,697.05 | Gross Loss | (\$8,541.83) |
| Total Number of Trades | 28 | Percent Profitable | 71.43% |
| Winning Trades | 20 | Losing Trades | 8 |
| Even Trades | 0 | | |
| Avg. Trade Net Profit | \$1,184.11 | Ratio Avg. Win:Avg. Loss | 1.95 |
| Avg. Winning Trade | \$2,084.85 | Avg. Losing Trade | (\$1,067.73) |
| Largest Winning Trade | \$7,145.28 | Largest Losing Trade | (\$2,232.23) |

While last year was down the circled stats are all impressive. An average gain of nearly 1.2% for the 4-day period along with a profit factor of 5 is very good.

One other observation worth pointing out is that despite the rally today the CBI jumped from 1 to 3 with the addition of 2 new Catapult System triggers. In looking at the S&P 100 components I noticed that there are several that appear primed to trigger (or trigger again). What this means is that any kind of selling over the next few days could cause a spike in the CBI. We could easily see it move from 3 up to 7 or more with even a moderate selloff on Friday. And 2 days of selling could cause this indicator to reach extreme levels (10+), signaling a strong possibility of an oversold bounce.

There is no change to the short-term Active List tonight from last night.

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 closed *just barely* below 0. Readings below 0 mean the SPX outperformed expectations over the last few days. So net expectations are for upside but the SPX is slightly overbought versus recent expectations. This is considered a neutral configuration. It can be seen on the chart whenever both lines close on opposite sides of 0. Due to this the Aggregator System moved from long to flat 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 1,322.24. This is about 1/4% below Thursday's close. So even just a mild close lower might trigger another long trade on Friday.

The SPX managed to do the bare minimum needed in order to turn the black Differential Line back into negative territory. That was good enough for us to make money on the SPY trade idea, but the Aggregator System actually took a small loss with this one. The difference was the gap down Monday morning. The Aggregator System assumes all

entries take place at the close, but the subscriber letter did not suggest a trade until Monday's open.

I will begin tracking the XIV trading systems next week with the Tuesday's close being the 1st allocation. Both the aggressive and the conservative version would have been 100% long from the 20th through Thursday. While the SPX declined 0.6% over the period, *XIV actually gained 1.8%*. It was aided by 1) the drop in the VIX and 2) the contango configuration in the VIX futures.

I feel the XIV trading systems have great potential as they look to take advantage of both directional edges and term structure. This past month would have been outstanding for the systems. Still, I believe that with this strong upside potential there is also strong potential for volatility and drawdown. If a summer selloff occurs and spikes the VIX these systems could take a substantial hit. Traders considering tracking the XIV systems should keep this in mind. I've said before that I always recommend unusually small position sizes whenever someone begins trading a new system. This allows you to build up some profits as well as a comfort level and confidence with the system before putting substantial amounts at risk. For more information on the XIV trading systems you may check out the videos page.

<http://www.quantifiableedges.com/members/videos.php>

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.

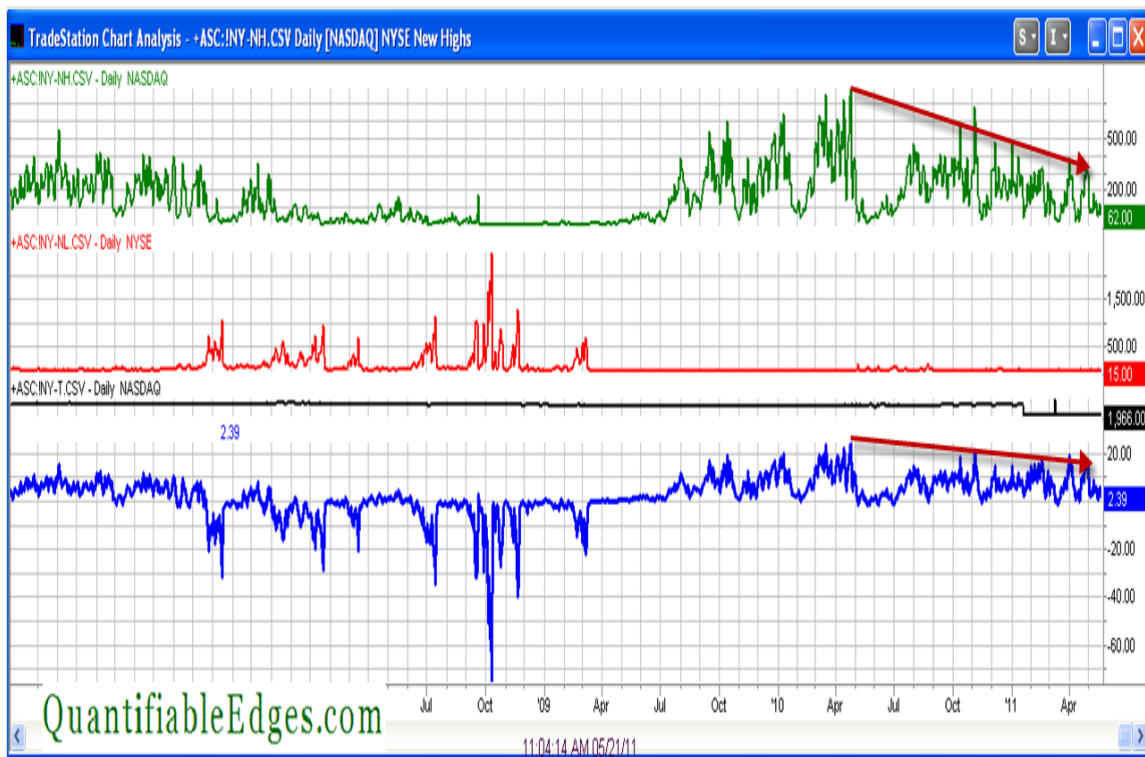
So are we seeing a mini move down, or is this the start of something big?

Breadth can often provide clues about impending tops. Major tops almost always see a divergence of breath 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 breath. 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.

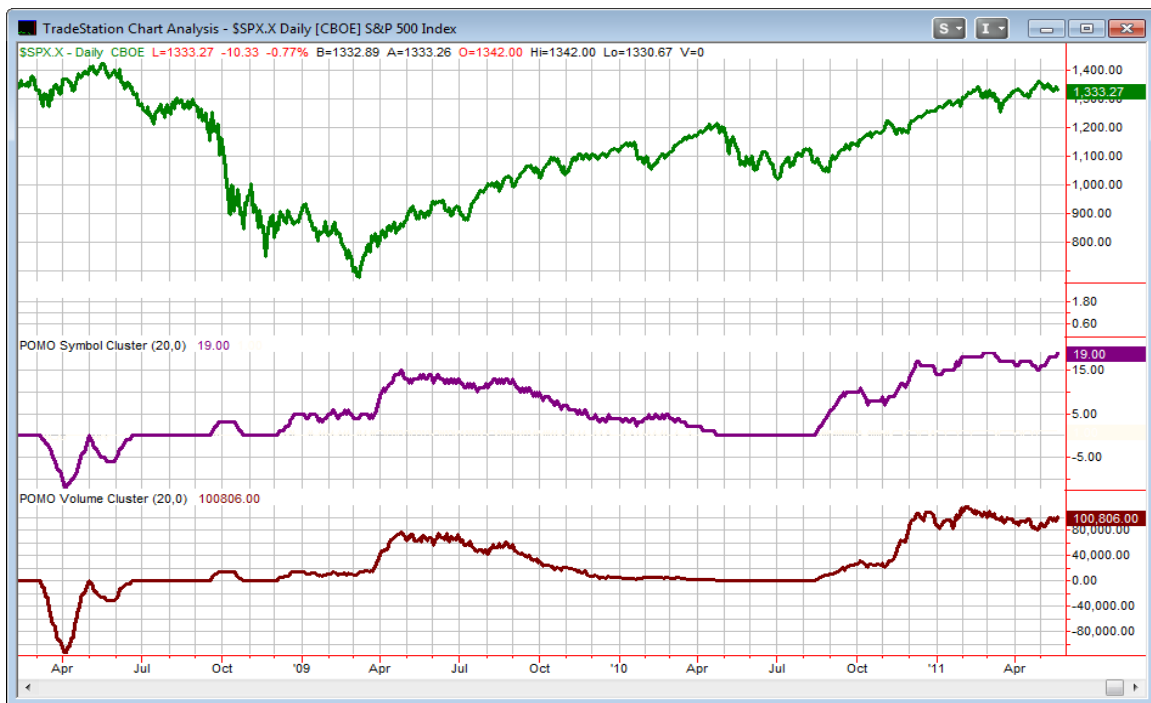


So between the advance/decline line and the decline in new highs breath is somewhat inconclusive. It doesn't appear to be suggesting a significant top is likely, but it does leave open the possibility.

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

New

PG – 1/3 position @ \$66.19

MRK – 1/3 position @ 36.38

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 3(GS, PG, MRK)

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.

PG – buy 1/3 position @ \$66.19 limit – based on Catapult system.

MRK – buy 1/3 position @ \$36.38 limit – based on Catapult system.

If you are new to Catapults I'd encourage you to learn more about them. The place to start would be the Catapult & CBI presentation, which can be found on the videos page. I've also linked to it below.

<http://www.quantifiableedges.com/videos/QE20100621.html>

Or for traders that would like to take a detailed look at the trades, you can see all of the ones that were tracked by the subscriber letter on the Trade Idea Results Spreadsheet (downloadable near the bottom of the systems page). One thing that I would note is that while the trades have done very well over the years, they have also been very volatile and there were some sizable losses along the way.

Current Open Trade Ideas

| Symbol | Entry Date | Entry Price | Current Price | % Gain/Loss | Stop | Notes |
|----------|------------|-------------|---------------|-------------|------|---------------|
| SPY(1/4) | 5/23/2011 | \$131.98 | \$133.00 | 0.77% | | sold on close |
| GS(1/3) | 5/23/2011 | \$133.64 | \$136.26 | 1.96% | | Catapult |
| | | | | | | |
| | | | | | | |

This report has been prepared by Hanna Capital Management, LLC and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy securities. While information contained herein is believed to be accurate at the time of publication, we make no representation as to the accuracy or completeness of any data, studies, or opinions expressed and it should not be relied upon as such. Robert Hanna, Hanna Capital Management, LLC or clients of Hanna Capital Management, LLC may have positions or other interests in securities (including derivatives) directly or indirectly which are the subject of this report. This report is provided solely for the information of Hanna Capital Management, LLC clients and prospects who are expected to make their own investment decisions without reliance upon this report. Neither Hanna Capital Management, LLC nor any officer or employee of Hanna Capital Management, LLC accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report may not be reproduced, distributed or published by any recipient for any purpose without the prior express consent of Hanna Capital Management, LLC.

Copyright © 2011 Hanna Capital Management, LLC.