

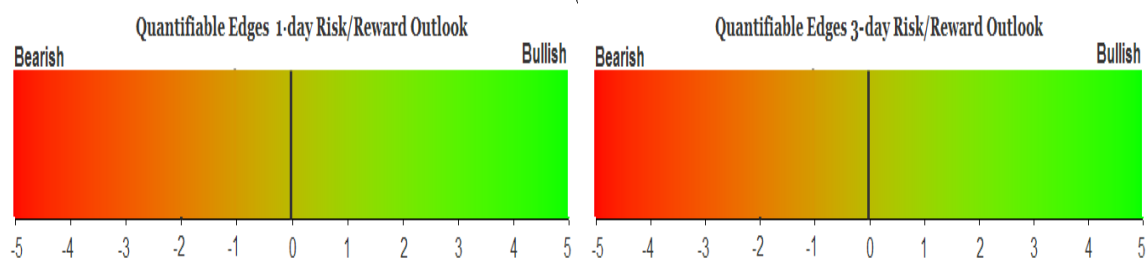
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 1, 2011

Volume 4 Issue 104

Market Overview



Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Flat	50% Long XIV	Flat	Flat

Tonight's Research Points

- Extremely high volume on an up day suggests bullish implications.
- .1st of month edge is reduced when the last 2 days close higher.
- The 3/10 Offset HV is extremely low – warning of a possible big move.

Short-term Outlook

The Bottom Line

Evidence is all pointing to a further rise, but the market is already overbought. I'm not inclined to buy at these levels. Instead I will patiently await a better risk/reward setup.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
June 1, 2011	SPX up. NYSE vol highest in 20 years	1-10 days	Bullish	2.60%
May 31, 2011	Memorial Week/1st of mth seasonality	1-4 days	Bullish	2.40%
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 31, 2011	4 Weeks Down. Close > 40ma.	1-10 weeks	Bullish	9.00%
March 22, 2011	3 Days Up Issues % > 70%	8 months	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

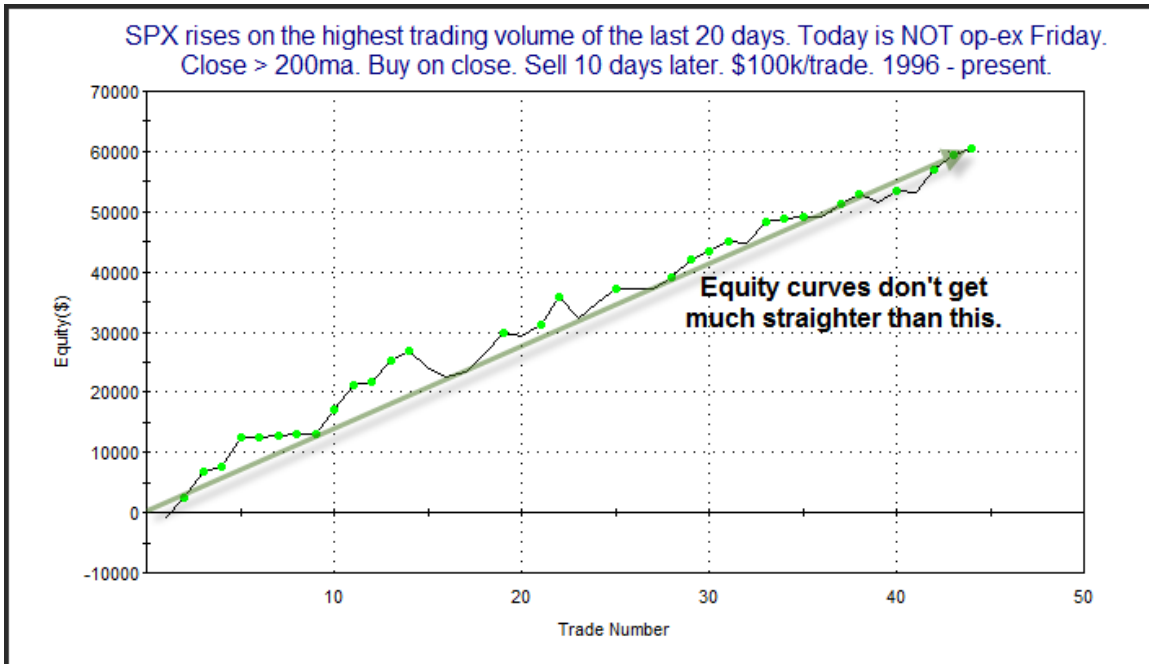
Tuesday was a strong day for the market. After a large gap up it spent the 1st half of the day pulling back. It then turned around and finished above the open and near its highs for the day. The final index numbers looked like this: SPX +1.1%, Nasdaq +1.4%, Russell 2000 +1.4%. Breadth was also strong as the NYSE Up Issues % came in at 76% and the Up Volume % was 81%. Total NYSE volume spiked to the highest level since mid-March.

The recent downtrending channel was broken Tuesday and it came on very high volume. And it was the volume that actually offered the strongest bit of evidence. When the market has risen on extremely high volume on a day other than op-ex Friday, that has typically been a very good sign. Below is a study last shown in the 12/21/09 subscriber letter that demonstrates this.

SPX rises on the highest trading volume of the last 20 days. Today is NOT op-ex Friday. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1996 - 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
15	84,299.85	42	31	11	73.81	3,382.10	-1,867.74	1.81	5.10	2,007.14
14	77,755.94	42	33	9	78.57	3,041.41	-2,512.29	1.21	4.44	1,851.33
13	73,886.56	42	33	9	78.57	2,867.33	-2,303.92	1.24	4.56	1,759.20
12	67,380.62	43	32	11	74.42	2,729.13	-1,813.78	1.50	4.38	1,566.99
11	58,755.63	43	34	9	79.07	2,293.83	-2,137.18	1.07	4.05	1,366.41
10	60,424.46	44	33	11	75.00	2,168.10	-1,011.16	2.14	6.43	1,373.28
9	54,412.36	44	33	11	75.00	2,032.46	-1,150.79	1.77	5.30	1,236.64
8	51,172.26	44	35	9	79.55	1,830.69	-1,433.56	1.28	4.97	1,163.01
7	39,116.27	46	34	12	73.91	1,797.50	-1,833.22	0.98	2.78	850.35
6	38,552.60	48	34	14	70.83	1,794.95	-1,605.40	1.12	2.72	803.18
5	26,602.23	48	32	16	66.67	1,570.01	-1,477.39	1.06	2.13	554.21
4	24,865.32	51	32	19	62.75	1,462.71	-1,154.81	1.27	2.13	487.56
3	16,226.41	53	35	18	66.04	1,129.47	-1,294.72	0.87	1.70	306.16
2	5,982.95	54	33	21	61.11	824.72	-1,011.08	0.82	1.28	110.80
1	8,503.37	66	39	27	59.09	605.59	-559.80	1.08	1.56	128.84

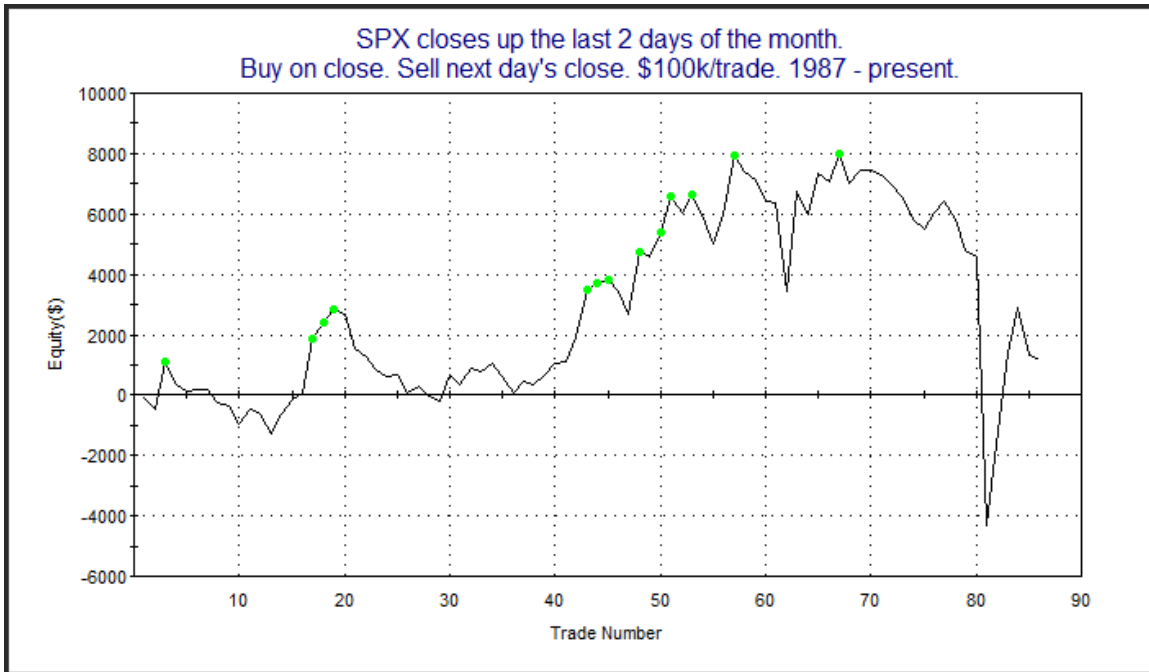
88% of instances posted a close above the entry price at some point in the next week. 97% did so within 2 weeks.

The statistics appear to suggest a strong bullish edge up to as much as three weeks out. Much of the edge is realized in the first two weeks. Below is an equity curve using a 10-day exit strategy that shows how the edge has played out over time.



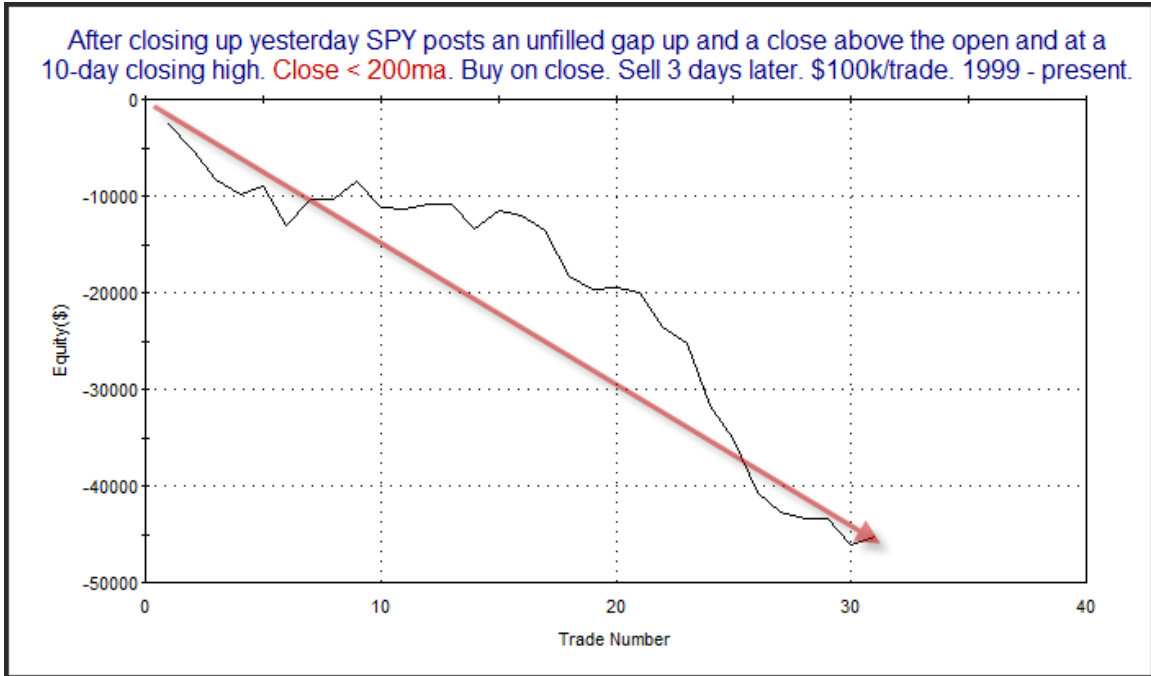
This is about as pretty of equity curve as you'll ever see. It serves as a nice confirmation of the upside edge suggested by the statistics table.

Last night I showed a study that combined "first of the month" bullish inclinations with Memorial week bullish inclinations. It appeared to suggest some strong seasonality in play for Wednesday. But market action over the last couple of days has thrown us a bit of a curveball. The 1st of the month, while historically bullish, has not fared as well when the market is already overbought. The study below was last seen in the 5/2/11 Letter.

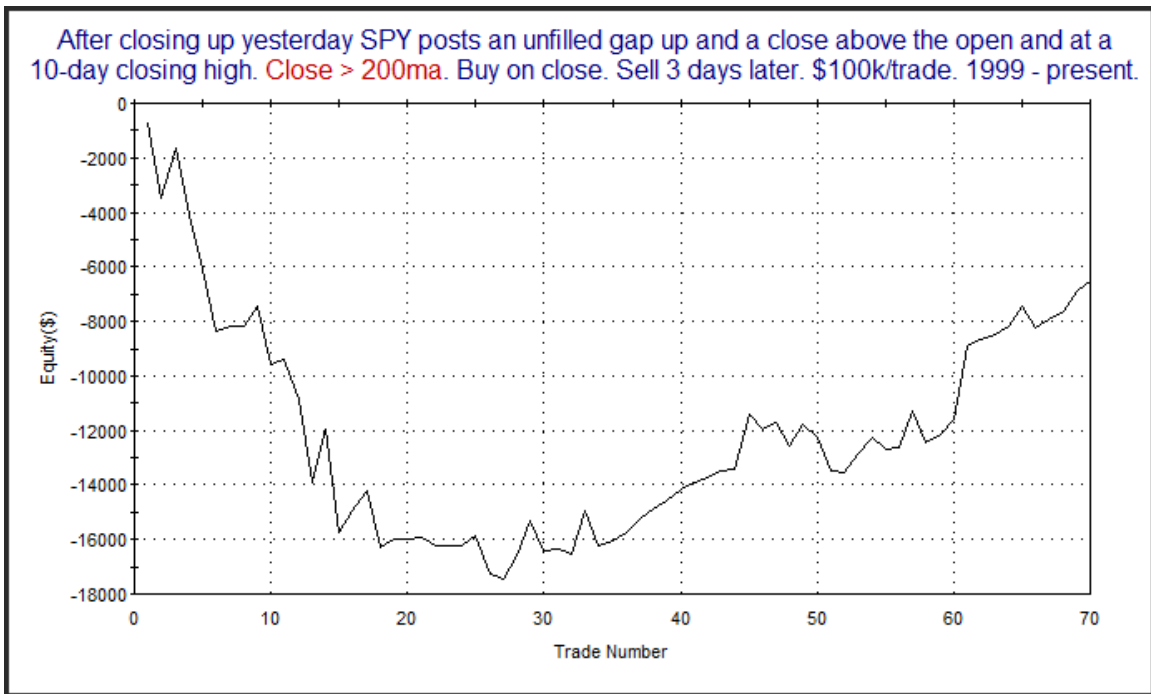


If you can spot a consistent and tradable edge here then your eyesight is much better than mine. At the least this would appear to dampen Wednesday's seasonally bullish inclinations.

There were a few studies that appeared in the Quantifinder tonight that appeared to suggest bearish implications. When I filtered a little more specifically they seemed to lose their bite. The study below was last seen in the 3/4/11 subscriber letter. Tonight I decided to add a 200ma filter and see if it held up in uptrends as well as downtrends. These first results below show when the setup occurs in a long-term downtrend.



This appears to be an edge that I would pay attention to. But now let's look at times like now where the market is locked in a long-term uptrend.



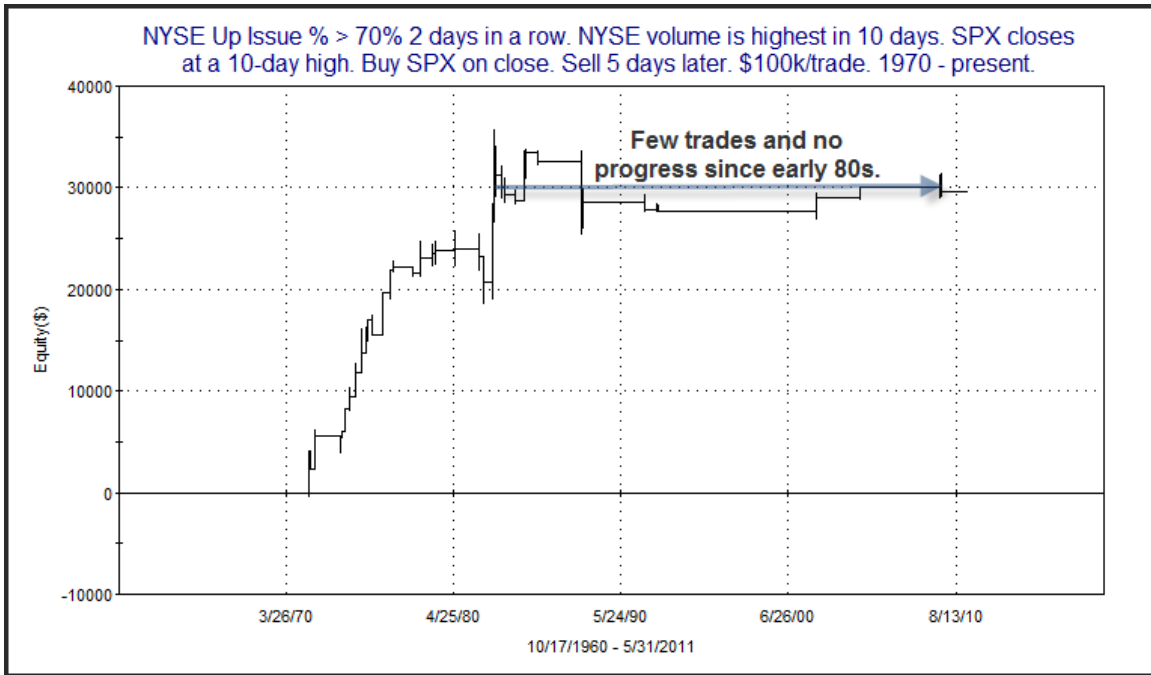
Results got off to a bearish start but the equity curve has been rising for a while now. There doesn't seem to be a consistent edge here either way.

Lastly, a study from the 9/17/09 letter that looked at breadth, volume, and price appeared. I have updated that study below.

NYSE Up Issue % > 70% 2 days in a row. NYSE volume is highest in 10 days. SPX closes at a 10-day high. Buy SPX on close. Sell X days later. \$100k/trade. 1970 - 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	29,548.91	36	23	13	63.89	2,012.96	-1,288.40	1.56	2.76	820.80
4	24,341.72	37	24	13	64.86	1,832.58	-1,510.78	1.21	2.24	657.88
3	14,270.02	38	23	15	60.53	1,522.80	-1,383.62	1.10	1.69	375.53
2	20,365.69	38	26	12	68.42	1,128.19	-747.27	1.51	3.27	535.94
1	6,336.88	40	22	18	55.00	738.08	-550.05	1.34	1.64	158.42

This stats table certainly appears to suggest an upside edge. But stats can sometimes be misleading. Below is a long-term equity curve.



As you can see, this setup was both frequent and strong in the 70s and even into the 80s. Since then there have been very few trades and flat results. Therefore, despite the nice-looking stats table this is not a study I would include on the Active List.

So despite all the studies tonight it appears the only one worth adding to the Active List was the high-volume study.

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 of the active studies are currently bullish. Meanwhile, the black Differential Line is now far 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 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 remained flat at the close.

The green Aggregator line is again set to close above 0 on Wednesday. This could change if strong bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,331.40. This is about 1.0% below Tuesday's close. So to push the Differential Line back into positive territory would take a sizable drop on Wednesday.

While the evidence continues to point towards more upside, the market remains too overbought for me to consider taking on new positions. Instead I'll manage the ones I have left and wait patiently for a better risk/reward scenario.

Intermediate-term Outlook (2 weeks – 2 months)– updated 5/31 – very slightly bullish

May has been a difficult month for the market. I'm sure many traders will welcome the end of it arriving on Tuesday. Even with Friday's gains the SPX experienced its 4th down week in a row. I decided to examine other times the SPX has posted 4 consecutive lower closes but still closed above its 40-week moving average.

SPX closes down for the 4th week in a row, but above its 40-week moving average. Buy on close. Sell X weeks later. \$100k/trade. 1975 - present.										
X	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	83,820.26	12	12	0	100.00	6,985.02	0.00	100.00	100.00	6,985.02
9	76,782.86	12	10	2	83.33	7,805.13	-634.23	12.31	61.53	6,398.57
8	57,176.35	12	9	3	75.00	7,290.42	-2,812.47	2.59	7.78	4,764.70
7	58,368.59	13	10	3	76.92	6,601.69	-2,549.43	2.59	8.63	4,489.89
6	58,698.10	13	8	5	61.54	8,057.78	-1,152.83	6.99	11.18	4,515.24
5	47,674.13	13	9	4	69.23	6,810.07	-3,404.13	2.00	4.50	3,667.24
4	43,252.27	13	9	4	69.23	6,091.52	-2,892.86	2.11	4.74	3,327.10
3	34,340.92	13	11	2	84.62	3,970.81	-4,668.98	0.85	4.68	2,641.61
2	27,496.07	13	10	3	76.92	3,522.23	-2,575.41	1.37	4.56	2,115.08
1	20,160.87	13	11	2	84.62	2,167.33	-1,839.91	1.18	6.48	1,550.84

**The 1 overlapping instance occurred on 7/9/04.
It too closed higher 10 weeks later.**

These results are strongly suggestive of an upside edge over the next several weeks. Below I have listed all 12 non-overlapping instances using a 10-week exit strategy.

SPX closes down for the 4th week in a row, but above its 40-week moving average. Buy on close. Sell X weeks later. \$100k/trade. 1975 - present.

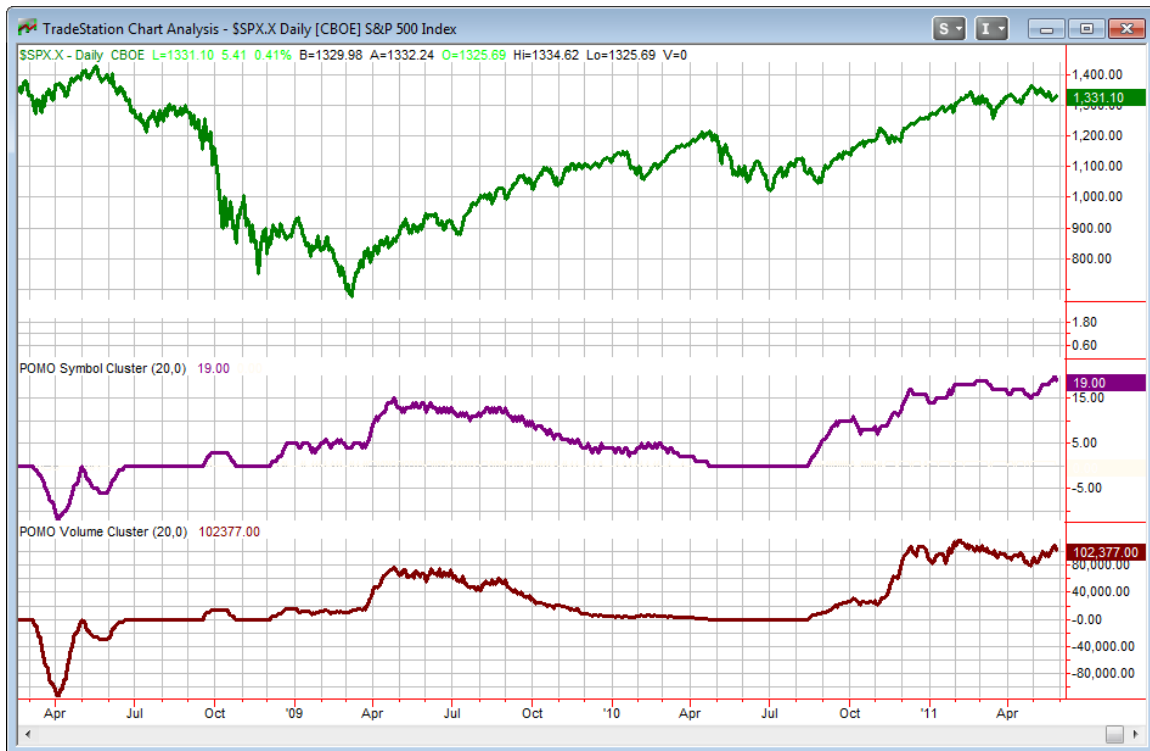
Date/Time	Signal	Price	% Profit	Run-up Drawdown
08/08/75	Buy	\$86.02	3.30%	\$3,997.28
10/17/75	Sell	\$88.86		(\$4,566.66)
06/04/76	Buy	\$99.15	5.14%	\$6,854.40
08/13/76	Sell	\$104.25		(\$524.16)
07/07/78	Buy	\$94.88	9.73%	\$13,868.01
09/15/78	Sell	\$104.11		(\$642.33)
11/04/83	Buy	\$162.44	2.82%	\$4,341.90
01/13/84	Sell	\$167.02		(\$1,131.60)
08/16/85	Buy	\$186.10	0.76%	\$1,793.58
10/25/85	Sell	\$187.52		(\$3,576.42)
08/26/88	Buy	\$259.67	6.41%	\$9,343.95
11/04/88	Sell	\$276.31		(\$1,039.50)
06/26/92	Buy	\$403.44	3.38%	\$5,357.43
09/04/92	Sell	\$417.08		\$0.00
04/04/97	Buy	\$757.90	17.86%	\$17,919.49
06/13/97	Sell	\$893.27		(\$3,191.16)
08/14/98	Buy	\$1,062.74	0.74%	\$4,126.60
10/23/98	Sell	\$1,070.65		(\$13,107.36)
05/21/04	Buy	\$1,093.59	0.74%	\$4,800.25
07/30/04	Sell	\$1,101.72		(\$1,347.71)
07/10/09	Buy	\$879.13	21.52%	\$22,033.87
09/18/09	Sell	\$1,068.30		(\$430.53)
02/05/10	Buy	\$1,066.19	11.81%	\$13,738.89
04/16/10	Sell	\$1,192.13		(\$900.24)

The only real alarming instance was '98 when the market experienced a 13% drop on the way to its 4% gain.

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>



Despite Friday being the first non-POMO day in over a month, both the POMO Days and POMO Volume indicators remain extremely elevated. 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. Three of the four days this upcoming week are schedule to see more buying. The only off day is Thursday.

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

Another notable indication on Friday can be seen on the charts page. There we see that the Nasdaq/SPX relative strength indicator is now suggesting the SPX is exhibiting relative strength over the Nasdaq. This is not necessarily a bearish configuration, but rather neutral. Most of the market's gains over the years have come with the Nasdaq leading.

It remains unclear whether the action throughout May is just a mini move lower or whether it is the start of something bigger. The new highs divergence I discussed in last week's intermediate-term outlook suggests a substantial decline is *possible*. The last couple of times the Fed abandoned POMO buying the stock market didn't seem to notice until about a month later. Of course this time may be different. From what I am seeing and reading it appears the end of QE2 is much more highly anticipated than other liquidity campaigns. There is a chance the market might begin to decline in anticipation of the end of these injections rather than feeling the effects post-QE2. On the bullish side, the market does remain in a long-term uptrend. It is trading above both its 50ma (barely) and its 200ma. The 4-week pullback study above provides some bullish evidence. Additionally, the breadth thrust signal given at the end of March has typically led to 8 months of continued gains and it has only been 2 months so far.

There still appears to be more evidence supporting the bullish case than the bearish one, though it continues to weaken. At this point I'm not inclined to aggressively bet against the long-term uptrend. I'm also not inclined to bet big on the long side. For my own trading, I'll continue to prefer long trades to short ones, but I'll likely be playing both sides fairly conservatively until the intermediate-term outlook provides more clarity.

Catapult and Capitulative Breadth Statistics

[*Catapult & CBI Presentation Link*](#)

Open Catapult Triggers

MRK – 1/3 position @ 36.38

ABT – 1/3 position @ \$51.55

MRK – 1/3 position @ \$36.21

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 3(2)(MRK(2), ABT)

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. The unfilled gap up on Tuesday didn't allow for any fills on the listed trade ideas.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
PG(1/3)	5/27/2011	\$66.04	\$67.00	1.45%		sell on open
MRK(1/3)	5/27/2011	\$36.38	\$36.75	1.02%		Catapult

PG hit its target and will be exited at the open.

MRK is very close to its target. An intraday gain of around \$0.15 would assure an exit will be triggered. Should MRK rally and gain \$0.15 early on I may trail a stop beneath it. If so, I will send out an intraday update to gold subscribers in order to alert them.

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