

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 2, 2011

Volume 4 Issue 105

Market Overview



Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Long	100% Long XIV	100% Long XIV	Flat

Tonight's Research Points

- 1-day drops from a 10-day high or a 10-day low often are followed by more selling.
- 2% drops like Wednesday's in uptrends suggest a bullish edge.
- Breadth was so extremely negative it is also suggesting a bounce.
- Last week's new numbered system, 110524, triggered for a large number of securities.

Short-term Outlook

The Bottom Line

Bloodbaths like Wednesday are often overreactions – especially when the market is in a long-term uptrend. Odds favor a bounce in the next day or two. I'll start building a long position on Thursday, and will add more if the opportunity presents itself after the jobs report on Friday.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
June 2, 2011	SPX up. NYSE vol highest in 20 years	1-3 days	Bearish	
June 2, 2011	2% drop. Bottom of range > 200ma	1-7 days	Bullish	
June 2, 2011	5% up vol > 200ma.	1-2 days	Bullish	
June 2, 2011	system 110524	1-7 days	Bullish	
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 in10.	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

The market got smacked hard on Wednesday as selling was strong and broad. The SPX and Nasdaq both fell 2.3% while the Russell 2000 lost 3.2%. Breadth was extremely weak as would be expected with the NYSE Up Issues % coming in at 18% and the Up Volume was a mere 4.8%. Total volume ran higher for most of the day but in the end came in slightly lower than yesterday's very high level.

Most of what appeared in the Quantifinder tonight suggested the selling was likely an overreaction and that we will likely get a bounce in short order. Not everything was bullish though. Before I get to the multitude of bullish evidence, let's first examine the one bearish study that really stuck out. Moving from a 10-day closing high to a 10-day closing low in 1 day is extremely unusual. It's something I last looked at in the 2/23/11 letter. As you'll see below it is something that has only happened 13 times in the last 50 years. Amazingly this is now the 3rd time it has happened this year. The table below is updated.

SPX closes at a 10-day low today after closing at a 10-day high yesterday.
Buy on close. Sell X days later. \$100k/trade. 1960 - 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	-2,345.84	13	6	7	46.15	1,551.35	-1,664.85	0.93	0.80	-180.45
4	-2,799.97	13	6	7	46.15	1,182.54	-1,413.60	0.84	0.72	-215.38
3	-5,701.93	13	5	8	38.46	787.48	-1,204.91	0.65	0.41	-438.61
2	-2,669.57	13	3	10	23.08	1,174.83	-619.40	1.90	0.57	-205.35
1	-2,160.37	13	5	8	38.46	553.10	-615.73	0.90	0.56	-166.18

It's not an overwhelming downside edge, and instances are a little low, but it still seems worthy of consideration. Below I have listed all instances assuming a 2-day holding period.

SPX closes at a 10-day low today after closing at a 10-day high yesterday.
Buy on close. Sell 2 days later. \$100k/trade. 1960 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
09/04/79	Buy	\$107.44	(0.55%)	\$158.10
09/06/79	Sell	\$106.85		(\$1,915.80)
12/01/80	Buy	\$137.21	(0.36%)	\$655.20
12/03/80	Sell	\$136.71		(\$2,074.80)
10/06/87	Buy	\$319.21	(1.59%)	\$53.21
10/08/87	Sell	\$314.15		(\$2,250.47)
01/08/88	Buy	\$243.39	0.83%	\$1,685.10
01/12/88	Sell	\$245.41		(\$1,201.30)
03/17/89	Buy	\$292.68	(0.46%)	\$0.00
03/21/89	Sell	\$291.33		(\$1,404.92)
05/13/93	Buy	\$439.23	0.26%	\$261.05
05/17/93	Sell	\$440.37		(\$317.80)
05/02/96	Buy	\$643.38	(0.40%)	\$785.85
05/06/96	Sell	\$640.81		(\$1,114.45)
03/20/02	Buy	\$1,151.85	(0.27%)	\$399.04
03/22/02	Sell	\$1,148.70		(\$1,063.82)
09/22/04	Buy	\$1,113.56	(0.31%)	\$22.25
09/24/04	Sell	\$1,110.11		(\$490.39)
06/06/08	Buy	\$1,360.44	(0.15%)	\$743.87
06/10/08	Sell	\$1,358.44		(\$716.86)
06/15/09	Buy	\$923.72	(1.41%)	\$462.24
06/17/09	Sell	\$910.71		(\$2,153.52)
01/28/11	Buy	\$1,276.34	2.45%	\$2,536.56
02/01/11	Sell	\$1,307.59		\$0.00
02/22/11	Buy	\$1,315.44	(0.71%)	\$187.72
02/24/11	Sell	\$1,306.10		(\$1,609.68)

This study serves as warning that sharp drops from a high level should normally not be bought too quickly.

But there are characteristics of Wednesday's selloff that suggest it should lead to a quick bounce. From a price standpoint alone, the action was extreme enough that a rebound typically follows almost immediately. On their own, 2% drops in uptrends tend to carry a bullish edge. Adding filters that require the selloff to finish the day weakly and at the lower end of its daily and 10-day range generate even more compelling results. Below is a study from the 4/28/10 Subscriber Letter that shows this.

SPY drops more than 2%, closes at a 10-day low and above its 200ma. Close is in the bottom 10% of daily range. 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	38,733.60	18	11	7	61.11	4,645.48	-1,766.66	2.63	4.13	2,151.87
9	47,002.01	20	15	5	75.00	3,873.23	-2,219.30	1.75	5.24	2,350.10
8	50,351.25	20	16	4	80.00	3,928.83	-3,127.52	1.26	5.02	2,517.56
7	49,215.96	20	17	3	85.00	3,430.15	-3,032.20	1.13	6.41	2,460.80
6	45,926.90	20	16	4	80.00	3,108.90	-953.89	3.26	13.04	2,296.35
5	39,906.37	20	15	5	75.00	2,964.04	-910.84	3.25	9.76	1,995.32
4	32,398.51	20	16	4	80.00	2,424.17	-1,597.06	1.52	6.07	1,619.93
3	33,827.21	20	16	4	80.00	2,319.91	-822.82	2.82	11.28	1,691.36
2	26,937.72	20	16	4	80.00	1,948.17	-1,058.24	1.84	7.36	1,346.89
1	19,674.47	20	18	2	90.00	1,171.43	-705.63	1.66	14.94	983.72

All 20 instances closed above the entry price in one of the next 2 days.

As you can see there has not only been a bounce within 2 days in every instance but the bounce has typically followed through over the next several days as well.

But it wasn't just price action that was extreme. Breadth was tremendously negative. The NYSE Up Volume % of 4.8% suggests nearly everything was being sold. Indiscriminate selling like this hints at panic. The study below was last seen in the 5/17/10 Subscriber Letter.

NYSE Up Volume % < 5%. SPX close > 200ma.
Buy SPX opn close. Sell X days later. \$100k/trade. 1988 - 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	18,206.37	8	6	2	75.00	4,114.69	-3,240.89	1.27	3.81	2,275.80
9	22,997.14	8	7	1	87.50	3,449.99	-1,152.80	2.99	20.95	2,874.64
8	23,210.80	8	8	0	100.00	2,901.35	0.00	100.00	100.00	2,901.35
7	23,463.24	8	8	0	100.00	2,932.90	0.00	100.00	100.00	2,932.90
6	16,196.73	9	7	2	77.78	3,166.35	-2,983.85	1.06	3.71	1,799.64
5	18,949.97	9	7	2	77.78	3,348.27	-2,243.98	1.49	5.22	2,105.55
4	11,398.95	9	7	2	77.78	2,687.90	-3,708.17	0.72	2.54	1,266.55
3	11,800.24	9	7	2	77.78	2,066.51	-1,332.66	1.55	5.43	1,311.14
2	12,164.71	9	7	2	77.78	1,892.75	-542.27	3.49	12.22	1,351.63
1	6,893.92	9	6	3	66.67	1,532.13	-766.28	2.00	4.00	765.99

**All 9 instances closed above the entry price
in one of the next 2 days.**

Instances here are quite low, but like the last study every instance showed a positive return on either day 1 or day 2.

Just last week in the 5/24/11 Subscriber Letter I published some extensive research about extreme selloffs that put the market at 20-day lows while still above the 200ma.

SPX closes at a 20-day low. Close > 200ma. Today's loss is the largest in 10 days.
Buy on close. Sell X days later. \$100k/trade. 1991 - 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	53,156.57	51	35	16	68.63	2,370.61	-1,863.42	1.27	2.78	1,042.29
9	65,512.77	52	40	12	76.92	2,119.35	-1,605.10	1.32	4.40	1,259.86
8	62,929.24	52	37	15	71.15	2,343.92	-1,586.39	1.48	3.64	1,210.18
7	74,955.71	53	42	11	79.25	2,215.13	-1,643.61	1.35	5.15	1,414.26
6	69,117.72	54	40	14	74.07	2,216.01	-1,394.46	1.59	4.54	1,279.96
5	60,219.23	54	34	20	62.96	2,259.26	-829.78	2.72	4.63	1,115.17
4	39,908.10	56	36	20	64.29	1,752.85	-1,159.72	1.51	2.72	712.64
3	32,921.20	56	39	17	69.64	1,386.79	-1,244.93	1.11	2.56	587.88
2	32,780.91	57	39	18	68.42	1,223.46	-829.66	1.47	3.20	575.10
1	14,235.79	59	39	20	66.10	740.60	-732.37	1.01	1.97	241.28

Results here are very solid and suggest a solid upside edge. When I looked at it more detail last week I found them compelling enough that I created a new numbered system based on them. System 110524 is now found on the triggers page, and there were several stocks and ETFs that triggered tonight based on the setup. For the system, rather than a

time-based exit, the exit calls for a close above the 10ma. The performance report below shows updated stats for SPX over the last 20 years.

SPX closes at a 20-day low. Close > 200ma. Today's loss is the largest in 10 days.
Buy on close. Sell on close > 10ma. \$100k/trade. 1991 - present.

TradeStation Performance Summary Collapse ▲			
All Trades			
Total Net Profit	\$73,212.73	Profit Factor	10.50
Gross Profit	\$80,917.12	Gross Loss	(\$7,704.39)
Total Number of Trades	52	Percent Profitable	86.54%
Winning Trades	45	Losing Trades	7
Even Trades	0		
Avg. Trade Net Profit	\$1,407.94	Ratio Avg. Win:Avg. Loss	1.63
Avg. Winning Trade	\$1,798.16	Avg. Losing Trade	(\$1,100.63)
Largest Winning Trade	\$7,070.28	Largest Losing Trade	(\$3,275.60)
Max. Consecutive Winning Trades	18	Max. Consecutive Losing Trades	1

There seem to be quite a few indications that the selling is already becoming exhaustive. The market is hitting short and intermediate-term lows during a long-term uptrend. Wednesday's drop was especially large. Breadth was extremely negative. And the close at the lows of the day also suggests a bit of panic. But is exhaustive selling likely to occur one day after the market makes a 10 day high? More often you see selling become overdone after the market is already at or near new lows. Odds seem to favor a bounce here in the next day or two but Friday's jobs report is a pretty big wildcard. Disappointing numbers in the ADP jobs report served as part of the catalyst for the selloff Wednesday. The Friday report could now be even more impactful than usual.

We may be setting up for a tight day on Thursday. Often large range days like we saw on Wednesday are quickly followed by narrow range days. With traders eagerly awaiting the Friday report the market could find itself in a relatively tight range on Thursday. I'll use that opportunity to take some long exposure ahead of Friday's report, but I don't intend to go overboard. If we do see more strong selling on Friday I expect it will quickly be followed by a strong bounce next week. So I am looking for a small amount of exposure on Thursday, but will ramp it up on Friday if the opportunity presents itself.

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. Meanwhile, the black Differential Line jumped back above 0 on Wednesday. Readings above 0 mean the SPX has underperformed expectations over the last few days. So net expectations are for upside and the SPX is oversold versus recent expectations. Historically this has provided an upside edge. This configuration can be seen on the chart whenever both lines close above 0. Due to this the Aggregator System turned long at the close.

The green Aggregator line is again set to close above 0 on Thursday. This is unlikely to change. Meanwhile, the Differential Pivot will be 1,338.04. This is about 1.8% above Wednesday's close. It will be a tall order to flip either line and the Aggregator appears to be suggesting a multi-day bounce here.

As I said above, it appears the market should bounce in the next day or so. Therefore I want to get some long exposure here. I don't want to go overboard ahead of Friday's jobs report though. Should the market continue lower Thursday and react poorly to the jobs on Friday morning I would likely become an aggressive buyer.

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.

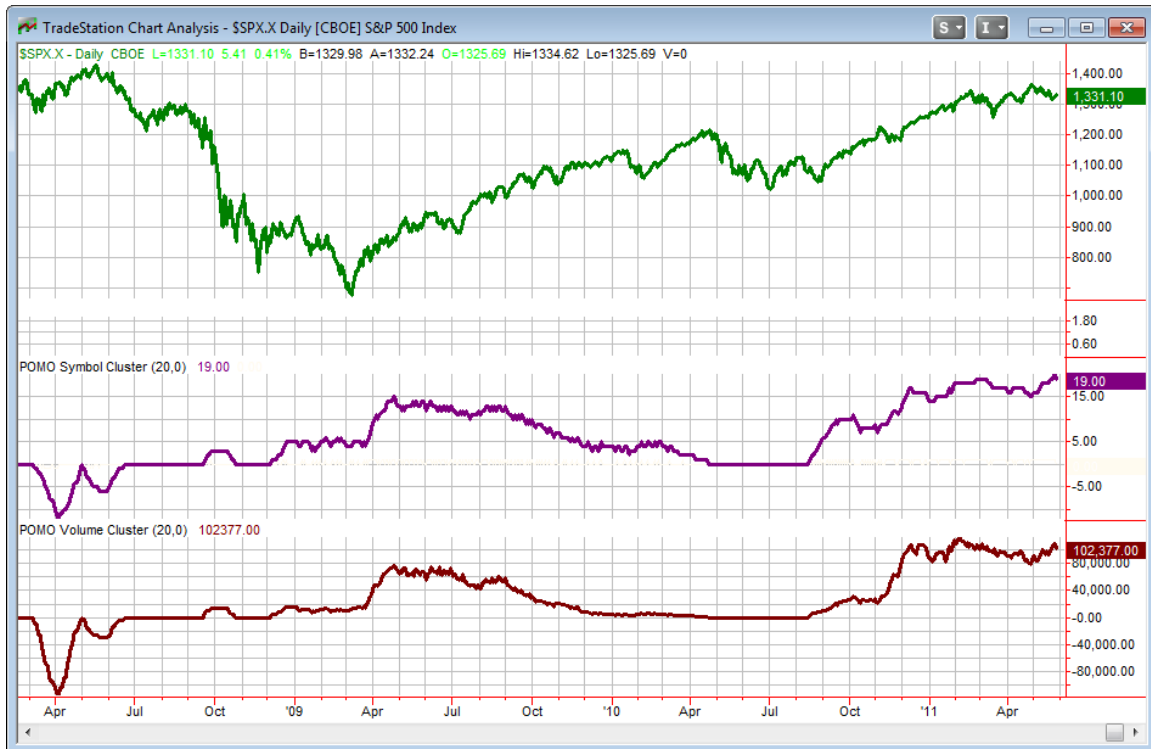
Date/Time	Signal	Price	% Profit	Run-up Drawdown
08/08/75	Buy	\$86.02	3.30%	\$3,997.28
10/17/75	Sell	\$88.86		(\$4,566.66)
06/04/76	Buy	\$99.15	5.14%	\$6,854.40
08/13/76	Sell	\$104.25		(\$524.16)
07/07/78	Buy	\$94.88	9.73%	\$13,868.01
09/15/78	Sell	\$104.11		(\$642.33)
11/04/83	Buy	\$162.44	2.82%	\$4,341.90
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.

SPY – buy ¼ index position @ \$131.87 limit. Based on short-term outlook above.

MRK – buy 1/3 position @ \$36.21 limit ON CLOSE. I'll take another shot at entering the 2nd lot of this catapult if it closes below its original trigger.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
PG(1/3)	5/27/2011	\$66.04	\$66.96	1.39%		sold on open
MRK(1/3)	5/27/2011	\$36.38	\$36.25	-0.36%		Catapult

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