

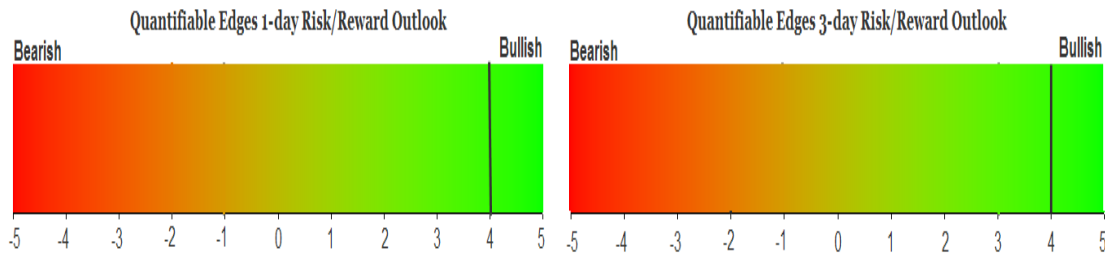
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 7, 2011

Volume 4 Issue 108

Market Overview



Signals Overview

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

Tonight's Research Points

- 2 unfilled down gaps and a 5-day appear to carry bullish inclinations.
- A strong move to a 50-day low on light volume has led to some lasting bottoms in the past.
- 4 days lower has the market primed for a bounce – especially considering Mondays extremely weak breadth.

Short-term Outlook

The Bottom Line

I remain long and expecting a bounce. The market is strongly oversold and there is a good amount of bullish evidence. The only worry at this point is that the market may be acting outside of historical norms.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
June 7, 2011	4 down days and very weak breadth	1-2 days	Bullish	
June 7, 2011	1% drop to 50-low on weak vol	1-3 days	Bullish	
June 7, 2011	2 unfilled gaps & 5 day low	1-5 days	Bullish	
June 6, 2011	Unfilled gap at low	1-3 days	Bullish	2.10%
June 6, 2011	SPX < BB. No VIX spike.	1-2 days	Bearish	-1.40%
June 3, 2011	Dn 2 days (early mnth & big/small drop)	1-9 days	Bullish	4.20%
June 2, 2011	2% drop. Bottom of range > 200ma	1-7 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%
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	
Dropped Tonight				
May 24, 2011	SPX dn 1%. Decliners 2x advancers	1-9 days	Bullish	3.05%
June 6, 2011	1st Friday down	1 day	Bullish	

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

The Evidence

Despite the fact that the market was already strongly oversold and evidence was suggesting a bounce was likely, stocks took a dive again on Monday. In the end the SPX and Nasdaq each lost 1.1% and the Russell 2000 fell 1.6%. Breadth was strongly negative as the NYSE Up Issue % came in at 20% and the Up Volume % was just 7%. Total NYSE volume declined for the 4th day in a row.

A high number of studies, all of which were bullish, appeared in the Quantifinder tonight. I've selected some of the most compelling to update and examine tonight. Rather than a long discourse I'll keep comments brief and offer more general observations at the end.

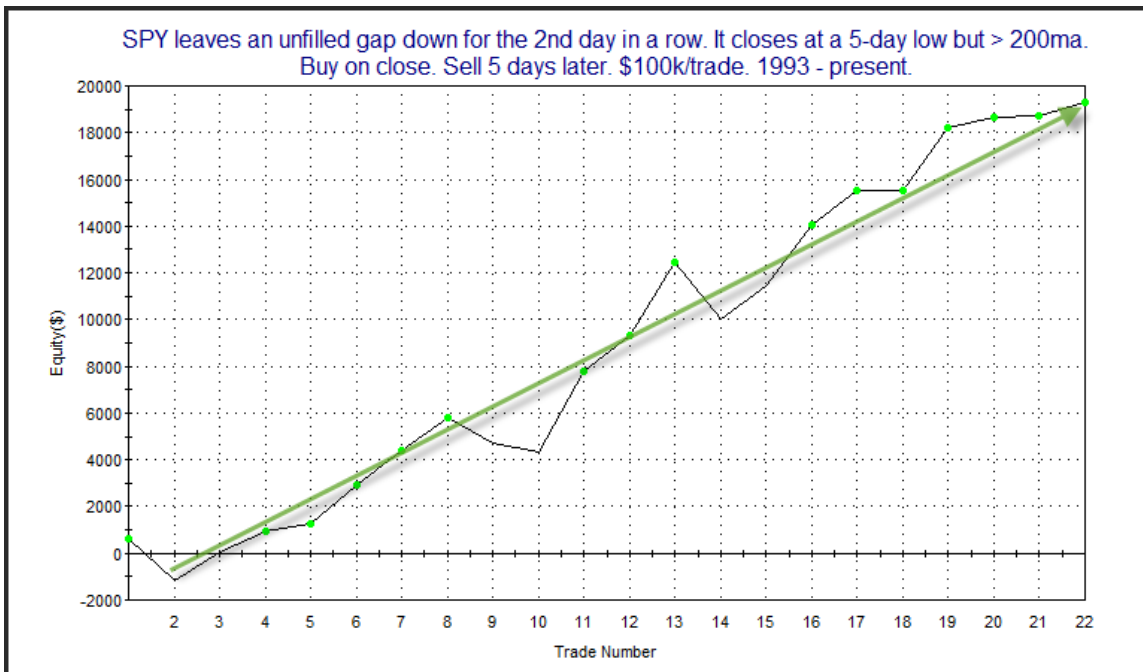
This first study looks at the recent SPY pattern. It was last published in the 3/16/11 Subscriber Letter. I have updated the results below.

SPY leaves an unfilled gap down for the 2nd day in a row. It closes at a 5-day low but > 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
5	19,299.31	22	18	4	81.82	1,393.53	-1,446.05	0.96	4.34	877.24
4	16,566.52	22	17	5	77.27	1,306.74	-1,129.62	1.16	3.93	753.02
3	12,395.54	22	15	7	68.18	1,162.84	-721.00	1.61	3.46	563.43
2	6,262.35	22	15	7	68.18	951.57	-1,144.45	0.83	1.78	284.65
1	1,280.78	23	14	9	60.87	692.11	-934.31	0.74	1.15	55.69

Only 1 instance failed to close above the entry price at some point in the next 5 days. That instance occurred on 9/14/99.

Results appear strong and consistent, especially with only 1 instance failing to bounce at all during the next week. Below is an equity curve using a 5-day exit strategy.



One common market misconception is that the market cannot bottom on low volume. This next study shows that isn't the case, and in fact strong, but low volume drops to 50-day lows have commonly suggested an upside edge. The study below was last seen in the 3/10/09 letter – marking the day of the huge '09 bottom.

SPX closes down at least 1% and at a 50-day low. NYSE volume is the lightest in 5 days.
Buy on 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	36,526.26	9	8	1	88.89	5,437.55	-6,974.13	0.78	6.24	4,058.47
9	27,767.55	9	7	2	77.78	4,852.07	-3,098.47	1.57	5.48	3,085.28
8	32,052.99	9	7	2	77.78	5,342.56	-2,672.47	2.00	7.00	3,561.44
7	34,788.30	9	7	2	77.78	5,632.82	-2,320.71	2.43	8.50	3,865.37
6	26,004.82	9	5	4	55.56	7,060.04	-2,323.84	3.04	3.80	2,889.42
5	25,696.12	11	7	4	63.64	4,391.22	-1,260.60	3.48	6.10	2,336.01
4	24,259.41	11	9	2	81.82	2,875.93	-811.97	3.54	15.94	2,205.40
3	24,135.60	11	10	1	90.91	2,543.12	-1,295.58	1.96	19.63	2,194.15
2	14,998.53	11	8	3	72.73	2,202.97	-875.08	2.52	6.71	1,363.50
1	9,908.14	11	8	3	72.73	1,566.76	-875.32	1.79	4.77	900.74

There is often an immediate bounce, and then after a pause or pullback the positive inclinations persist. Below I have listed all instances with a 10-day exit strategy.

SPX closes down at least 1% and at a 50-day low. NYSE volume is the lightest in 5 days.
Buy on close. Sell 10 days later. \$100k/trade. 1988 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
08/15/88	Buy	\$258.68	1.41%	\$1,574.88
08/29/88	Sell	\$262.33		(\$829.90)
01/22/90	Buy	\$330.37	0.45%	\$721.78
02/05/90	Sell	\$331.85		(\$3,183.08)
11/22/91	Buy	\$376.13	0.57%	\$1,656.25
12/09/91	Sell	\$378.26		(\$1,264.05)
10/09/92	Buy	\$402.65	2.84%	\$3,558.80
10/23/92	Sell	\$414.10		\$0.00
09/29/99	Buy	\$1,268.37	1.35%	\$5,520.84
10/13/99	Sell	\$1,285.55		(\$195.78)
04/29/02	Buy	\$1,065.45	0.86%	\$2,415.21
05/13/02	Sell	\$1,074.56		(\$1,533.57)
07/01/02	Buy	\$968.65	(6.99%)	\$2,565.73
07/16/02	Sell	\$900.94		(\$9,495.57)
10/07/02	Buy	\$785.28	14.57%	\$14,654.53
10/21/02	Sell	\$899.72		(\$2,109.47)
03/09/09	Buy	\$676.53	21.64%	\$21,585.48
03/23/09	Sell	\$822.92		\$0.00

The last 3 are large outliers but the results remain impressive nonetheless. Below are the instances using a 3-day exit strategy.

SPX closes down at least 1% and at a 50-day low. NYSE volume is the lightest in 5 days. Buy on close. Sell 3 days later. \$100k/trade. 1988 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
08/15/88	Buy	\$258.68	0.91%	\$1,574.88
08/18/88	Sell	\$261.03		(\$455.48)
08/22/88	Buy	\$256.97	0.86%	\$1,614.35
08/25/88	Sell	\$259.17		(\$171.16)
01/22/90	Buy	\$330.37	(1.30%)	\$721.78
01/25/90	Sell	\$326.08		(\$1,875.42)
11/22/91	Buy	\$376.13	0.11%	\$572.40
11/27/91	Sell	\$376.55		(\$1,195.15)
10/09/92	Buy	\$402.65	1.67%	\$2,199.76
10/14/92	Sell	\$409.37		\$0.00
09/29/99	Buy	\$1,268.37	2.86%	\$2,825.94
10/04/99	Sell	\$1,304.60		(\$195.78)
04/29/02	Buy	\$1,065.45	1.79%	\$2,415.21
05/02/02	Sell	\$1,084.56		(\$185.07)
05/06/02	Buy	\$1,052.67	1.93%	\$3,407.50
05/09/02	Sell	\$1,073.01		(\$348.74)
07/01/02	Buy	\$968.65	2.10%	\$2,103.26
07/05/02	Sell	\$989.03		(\$3,479.34)
10/07/02	Buy	\$785.28	2.37%	\$2,985.77
10/10/02	Sell	\$803.92		(\$2,109.47)
03/09/09	Buy	\$676.53	10.97%	\$11,186.70
03/12/09	Sell	\$750.74		\$0.00

In included this study on the Active list, but I excluded the last instance for purposes of generating estimates.

With Monday being the 4th down day in a row, several studies appeared in the Quantifinder related to that. This 1st one below is from the 2/1/10 Letter.

SPX makes 4 consecutive lower lows and today's low is the lowest in 20 days. Close > 200ma.
Buy on close. Sell X days later. \$100k/trade. March 1983 - 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	48,222.31	41	29	12	70.73	2,245.12	-1,407.19	1.60	3.86	1,176.15
9	50,679.80	41	31	10	75.61	2,211.78	-1,788.54	1.24	3.83	1,236.09
8	52,747.63	41	31	10	75.61	2,255.63	-1,717.69	1.31	4.07	1,286.53
7	49,913.71	41	28	13	68.29	2,202.09	-903.45	2.44	5.25	1,217.41
6	39,285.33	42	31	11	73.81	1,709.46	-1,246.18	1.37	3.87	935.37
5	27,958.43	42	27	15	64.29	1,648.03	-1,102.56	1.49	2.69	665.68
4	26,913.17	42	26	16	61.90	1,629.97	-966.63	1.69	2.74	640.79
3	11,423.57	42	22	20	52.38	1,321.48	-882.45	1.50	1.65	271.99
2	11,173.16	42	24	18	57.14	993.46	-703.89	1.41	1.88	266.03
1	2,117.15	42	27	15	64.29	605.80	-949.29	0.64	1.15	50.41

37 of 42 instances (88%) closed above the entry price at some point in the next week.

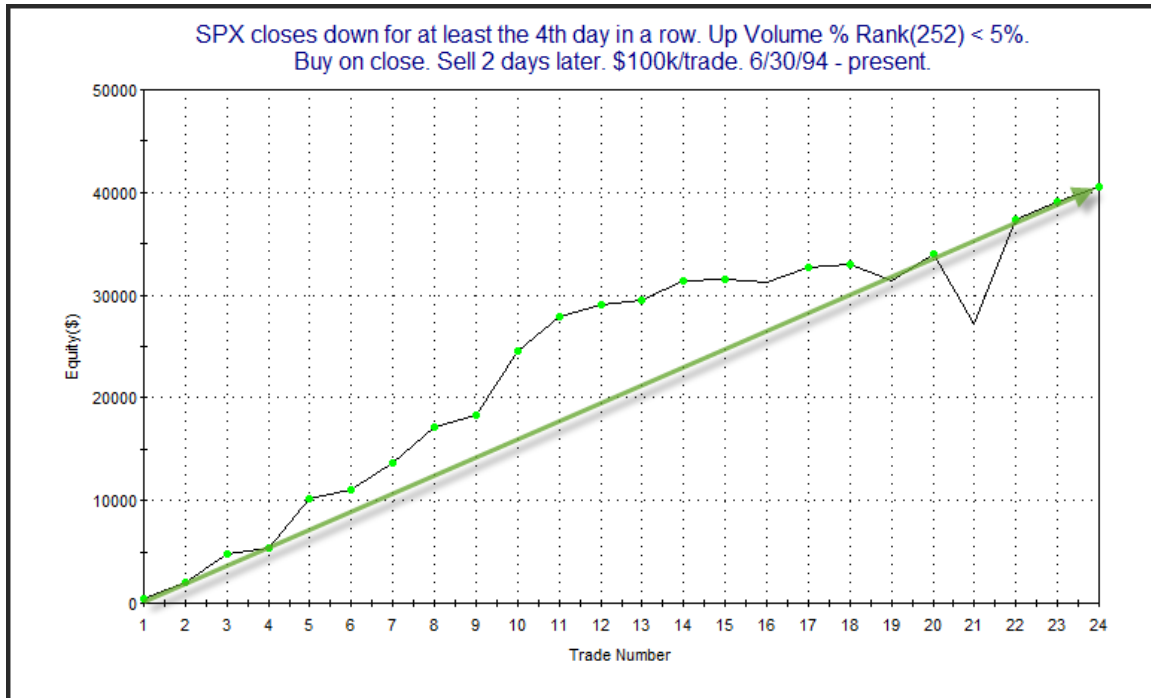
Results here appear solidly bullish. But beyond price action we also saw an extreme with regards to breadth. The Up Volume % finished in its bottom 2% for the last year. The study below was last seen on 11/17/10.

SPX closes down for at least the 4th day in a row. Up Volume % Rank(252) < 5%.
Buy on close. Sell X days later. \$100k/trade. 6/30/94 - 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	28,477.72	23	17	6	73.91	2,661.73	-2,795.29	0.95	2.70	1,238.16
4	10,366.02	23	16	7	69.57	2,053.24	-3,212.26	0.64	1.46	450.70
3	25,668.38	24	18	6	75.00	2,507.48	-3,244.39	0.77	2.32	1,069.52
2	40,614.50	24	21	3	87.50	2,337.67	-2,825.50	0.83	5.79	1,692.27
1	12,283.04	25	17	8	68.00	1,426.16	-1,495.22	0.95	2.03	491.32

The only instance that did NOT close above the entry price at some point in the next 2 days was 10/6/08.

This one appears both consistent and powerful. Below is the equity curve using a 2-day exit strategy.



Equity curves don't get much straighter than this. Overall this appears to be a very compelling study.

The market is clearly oversold. I continue to see compelling evidence suggesting a bounce is overdue. In fact 2 of the studies tonight have bounced nearly 100% of the time over the following few days. The problem is this is the 3rd day in a row that I've found studies suggesting overwhelming odds of a bounce. To this point the bounce has not come. It appears the market may be temporarily acting outside of historical norms. This is something that happens occasionally. To me this means a bit of extra caution is warranted. At this point I'm not inclined to put on the last lot of the index position until we either get a strong spike in the VIX or the CBI moves sharply above 10. I will continue to take Catapults as I typically do and will manage my other long positions based on market action.

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 is also well above 0. Readings above 0 mean the SPX has underperformed expectations over the last few days. So net expectations are clearly positive and the SPX is strongly 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 remained long at the close.

The green Aggregator line is again set to close above 0 on Tuesday. This is unlikely to change. Meanwhile, the Differential Pivot will be 1320.32. This is about 2.7% above Monday's close. It will again be a tall order to flip either line and the Aggregator appears to be suggesting a multi-day bounce here.

I'm quite long at the moment. Often I'd be looking to put on the last piece of my index position here. But I'm using a bit of caution and would prefer to see the VIX spike or the CBI spike strongly before adding more exposure there. I will consider a catapult and an XIV position if the VIX spikes tomorrow. Details in the trade ideas section below.

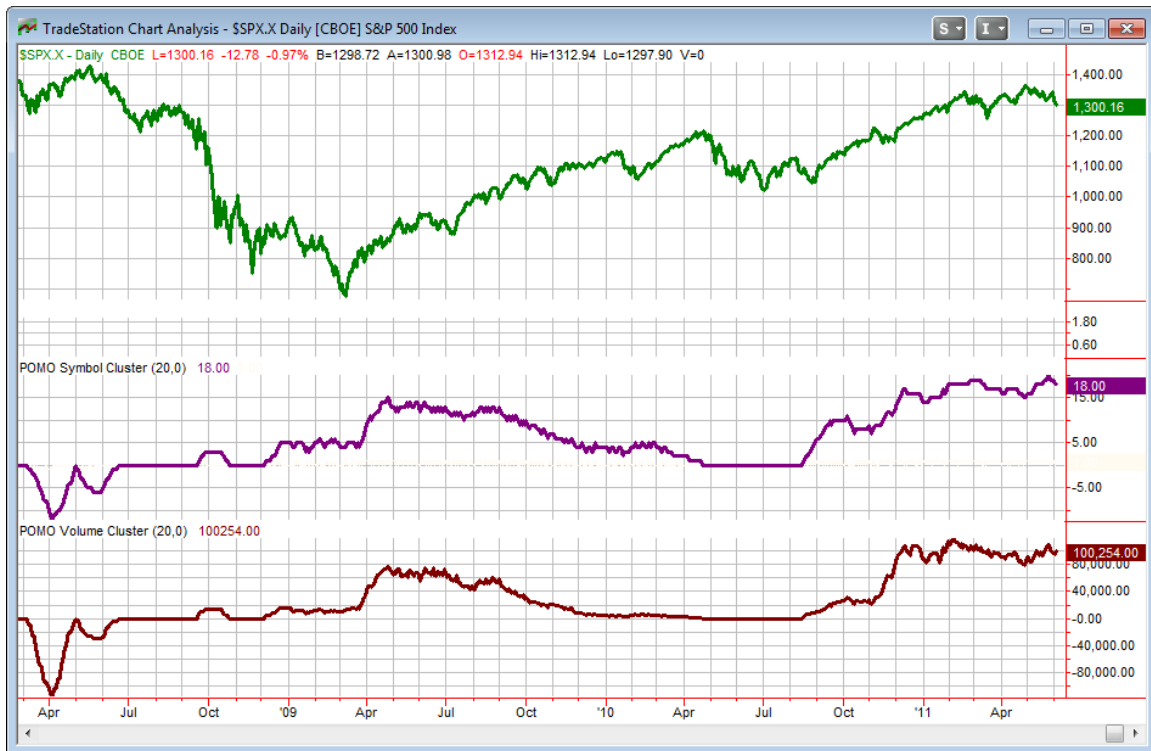
Intermediate-term Outlook (2 weeks – 2 months)– updated 6/6 – very slightly bullish

The SPX broke above its upper trend channel this past week and was promptly slapped back into it. Breakout failures can be bad signs and this action may suggest some caution. From a quantitative standpoint, not much was accomplished this past week. Therefore I am going to keep discussion in this section fairly short. There is one big intermediate-term indicator to watch this week, and that is POMO – specifically Friday’s schedule release.

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 remain extremely elevated. The liquidity pump continues to inject massive amounts of money into the system. But that pump is supposed to be shut off very soon. This week we very well may see exactly when the end will come and how much POMO volume is left. QE2 has been slated to end in June, but to this point no exact date has been provided. On Friday the next POMO schedule is set to be released, which will show scheduled activity for the next month. Many people are assuming the end of June will mark the end of POMO. We should see the date in this upcoming release. It could be that Thursday will be the last POMO day, and it could be that POMO may continue into July. While neither seem likely, it is likely that POMO uncertainty will be relieved. How the market responds to the end date will be interesting. The past few times POMO stimulus was halted, it took the market about a month after the halt until prices began to decline. In this case, they may already have begun their decline in anticipation of the end. Can the market continue a long-term trend higher without the aid of POMO? We'll soon see.

For those that would like to view the upcoming schedule through June 10th I have provided a link below. This link can also be used Friday afternoon to see the new schedule.

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

The intermediate-term studies still appear to favor the bullish case, though the trend over the last month plus has certainly been down. I'm still a bit more wary of the short side, though that doesn't mean I'm necessarily inclined to quickly take aggressive long positions. Instead, I'll continue to play 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 (2nd lot)

MCD – 1/3 position @ \$80.75

LOW – 1/3 position @ \$23.59

MCD – 1/3 position @ \$80.54(2nd lot)

LOW – 1/3 position @ \$23.40(2nd lot)

AEP – 1/3 position @ \$37.51

New

LOW – 1/3 position @ \$22.87(3rd lot)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 9(5)(MRK(2), ABT, MCD(2), LOW(3), AEP)

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.

XIV – buy @ \$172 LIMIT ON CLOSE. I put this trade idea out there the last 2 nights and will again tonight. The 1st VIX systems signals are already active. A VIX spike Tuesday would seem an excellent opportunity to go long XIV. If we do get a spike, it would likely be the last straw before the market bounces (and the VIX declines again). The limit on close price here is near the lows of the last couple of days.

LOW – buy 1/3 position @ \$22.87 limit. Based on Catapult system as listed above. This would be the 3rd and final entry for LOW.

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
MRK(1/3)	5/27/2011	\$36.38	\$35.56	-2.25%		Catapult
MRK(1/3)	6/2/2011	\$36.15	\$35.56	-1.63%		Catapult
SPY(1/4)	6/2/2011	\$131.87	\$129.04	-2.15%		Aggregator
SPY(1/4)	6/3/2011	\$130.15	\$129.04	-0.85%		Aggregator
ABT(1/3)	6/3/2011	\$51.04	\$51.02	-0.04%		Catapult
LOW(1/3)	6/3/2011	\$23.18	\$22.87	-1.34%		Catapult
MCD(1/3)	6/3/2011	\$80.11	\$80.70	0.74%		Catapult
LOW(1/3)	6/6/2011	\$23.07	\$22.87	-0.87%		bought on open
MCD(1/3)	6/6/2011	\$80.54	\$80.70	0.20%		bought at limit
AEP(1/3)	6/6/2011	\$37.43	\$37.58	0.40%		bought on open
SPY(1/4)	6/6/2011	\$129.04	\$129.04	0.00%		bought on close

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