

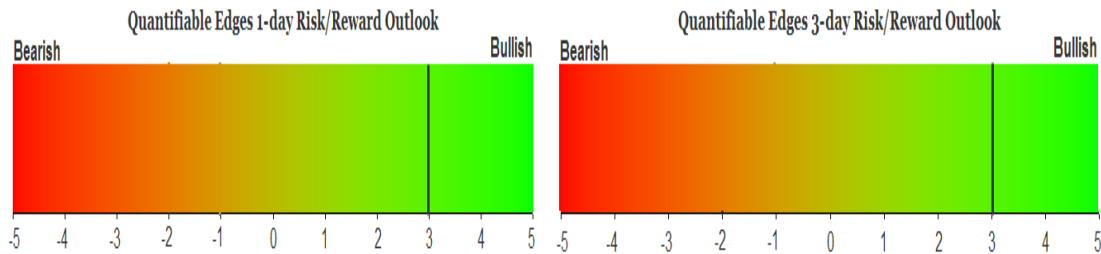
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 8, 2011

Volume 4 Issue 109

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- Squarely positive breadth on a down market day is typically bullish over the following days.

## *Short-term Outlook*

### *The Bottom Line*

The market is still oversold and I'm still expecting a bounce. While the failure to bounce to this point has me somewhat concerned, evidence continues to point higher.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
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%
<b>Active - Long Term</b>				
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	
<b>Dropped Tonight</b>				
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***

After working its way higher for much of the day the market fell apart in the last hour as Bernanke spoke on Tuesday. Strong gains turned into a mixed performance. The SPX closed down 0.1%. The Nasdaq declined less than that. The Russell 2000 actually managed a small 0.3% gain. Breadth was moderately positive as the NYSE Up Issues % came in at 56% while the Up Volume % was 52%. Total NYSE volume declined for the 5<sup>th</sup> day in a row.

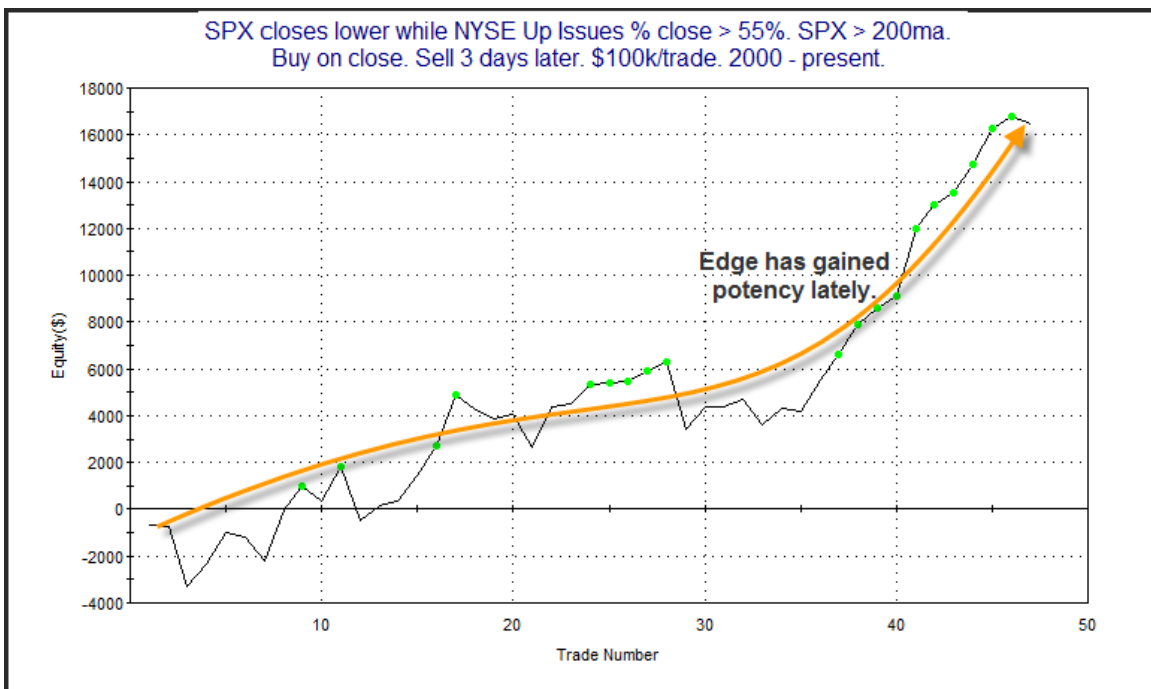
Not much showed up tonight that was both new and compelling. Most of the studies either showed marginal results or they were repeats from the last few days. One observation from today that suggests a bit of an upside edge is that while the SPX declined, breadth was still positive. The study below was last seen in the 4/6/11 letter. Results are updated.

SPX closes lower while NYSE Up Issues % close > 55%. SPX > 200ma.  
Buy on close. Sell X days later. \$100k/trade. 2000 - 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	16,875.20	44	28	16	63.64	1,386.88	-1,372.34	1.01	1.77	383.53
4	17,118.59	45	28	17	62.22	1,325.91	-1,176.87	1.13	1.86	380.41
3	16,439.04	47	33	14	70.21	928.51	-1,014.42	0.92	2.16	349.77
2	13,401.17	47	33	14	70.21	796.95	-921.31	0.87	2.04	285.13
1	10,275.14	49	30	19	61.22	656.42	-495.66	1.32	2.09	209.70

87% of instances closed above the entry price  
at some point in the next week.

The edge isn't huge, but it does appear to be high-percentage. The equity curve below gives a better idea of how the edge has played out over time.



While the curve certainly appears choppy, the slope has always been upwards, and recent results are stronger than ever. I believe this study is worth taking into consideration and including among the active studies.

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 Wednesday. This is unlikely to change. Meanwhile, the Differential Pivot will be 1,307.09. This is about 1.7% above Tuesday'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.

The market's failure to bounce despite being oversold and exhibiting strongly bullish inclinations based on the studies has me a bit concerned. We seem to be getting into that area of historically abnormal behavior. This increases risk. It's unusual for downmoves to exhibit strong persistence. Most often downmoves are represented by very choppy behavior. Of course it is June. Two of the most persistent downmoves in recent times

occurred during June - in 2008 and 2010. There is still a good amount of evidence suggesting a decent bounce is about to occur. I'm not going to reduce my position yet but I'm also not planning on adding to it at these levels. I will still consider taking an XIV position should we get a spike in the VIX.

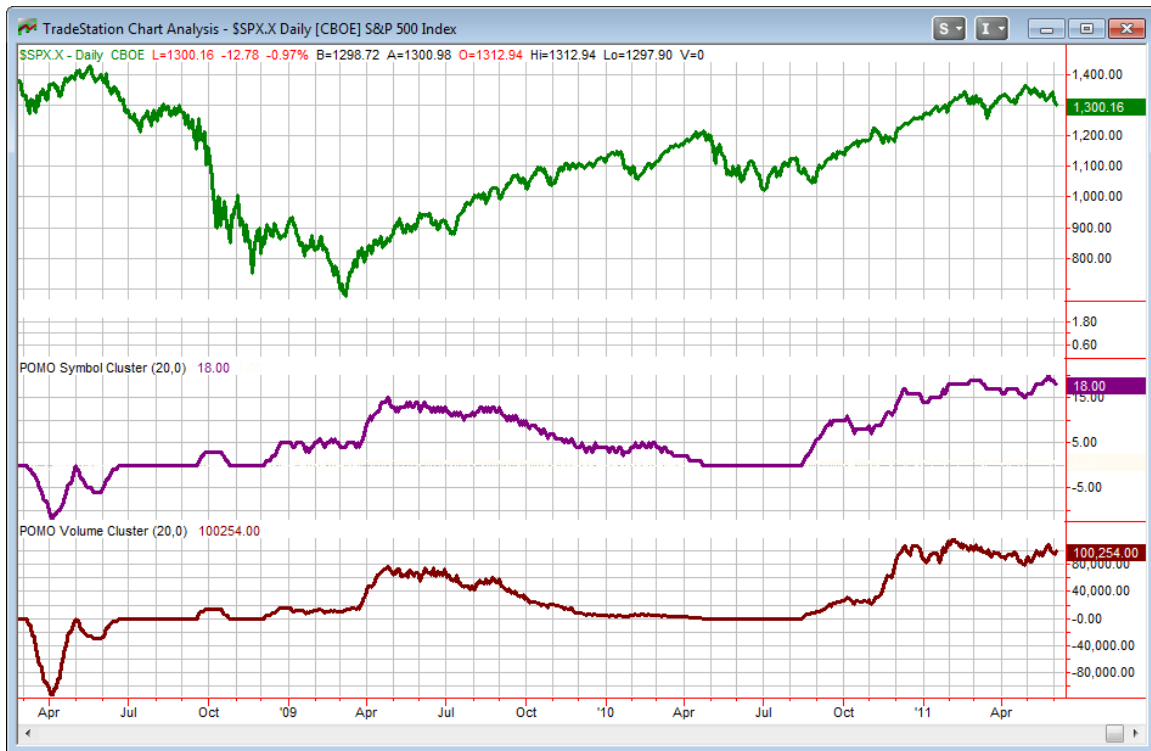
***Intermediate-term Outlook (2 weeks – 2 months)– updated 6/6 – very slightly bullish***

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 3<sup>rd</sup> 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](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 (2<sup>nd</sup> lot)*

*LOW – 1/3 position @ \$23.59*

*LOW – 1/3 position @ \$23.40(2<sup>nd</sup> lot)*

*AEP – 1/3 position @ \$37.51*

*LOW – 1/3 position @ \$22.87(3<sup>rd</sup> lot)*

#### ***Catapult for ETF's Trades***

*None*

***Broad Market Large Cap CBI – 7(4)( 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 few nights and will again tonight. The 1<sup>st</sup> VIX systems signals are already active. A VIX spike Wednesday 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 ON CLOSE.*** Based on Catapult system as listed above. We did not get a fill on this one on Tuesday. I'm playing it a little conservatively and avoiding buying into an intraday selloff. Instead I'll be looking to do my buying at the close.

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	\$35.57	-2.23%		Catapult
MRK(1/3)	6/2/2011	\$36.15	\$35.57	-1.60%		Catapult
SPY(1/4)	6/2/2011	\$131.87	\$128.96	-2.21%		Aggregator
SPY(1/4)	6/3/2011	\$130.15	\$128.96	-0.91%		Aggregator
ABT(1/3)	6/3/2011	\$51.04	\$51.38	0.67%		Catapult
LOW(1/3)	6/3/2011	\$23.18	\$22.99	-0.82%		Catapult
MCD(1/3)	6/3/2011	\$80.11	\$81.25	1.42%		<i>sold at intraday stop</i>
LOW(1/3)	6/6/2011	\$23.07	\$22.99	-0.35%		bought on open
MCD(1/3)	6/6/2011	\$80.54	\$81.25	0.88%		<i>sold at intraday stop</i>
AEP(1/3)	6/6/2011	\$37.43	\$37.57	0.37%		bought on open
SPY(1/4)	6/6/2011	\$129.04	\$128.96	-0.06%		bought on close

*MCD was sold at the intraday stop sent to gold subscribers around noon after GS reached its exit trigger.*

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