

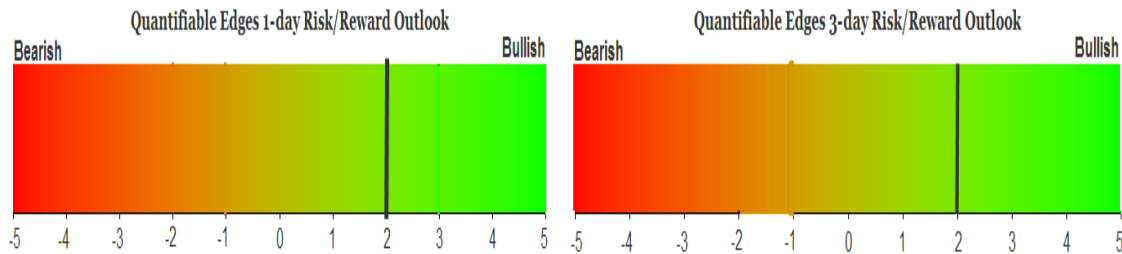
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 14, 2011

Volume 4 Issue 113

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- Weak breadth on a day the SPX rises suggests a downside edge.
- SPX and VIX both rising on a Monday is typically a short-term negative.

## Short-term Outlook

### The Bottom Line

Monday's action brought about some negatives, but it wasn't quite enough to turn the Aggregator (or me) bearish. I am still expecting a bounce and have quite a bit of long exposure in anticipation. I don't plan to add to my longs on Tuesday.

## 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 14, 2011	NYSE Up Issues % < 40%. SPX up.	1-3 days	Bearish	
June 14, 2011	SPX up. VIX up. Monday.	1 day	Bearish	
June 13, 2011	McClellan Osc % Rank < 2%. SPX 50 low	1-6 days	Bullish	3.70%
June 13, 2011	TICK Tomoscillator very low	1-2 days	Bullish	
June 3, 2011	Dn 2 days(early month & big/small drop	1-9 days	Bullish	
June 1, 2011	SPX up. High vol 20.	1-10 days	Bullish	
<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>				
June 7, 2011	2 unfilled gaps & 5 low	1-5 days	Bullish	

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

### *The Evidence*

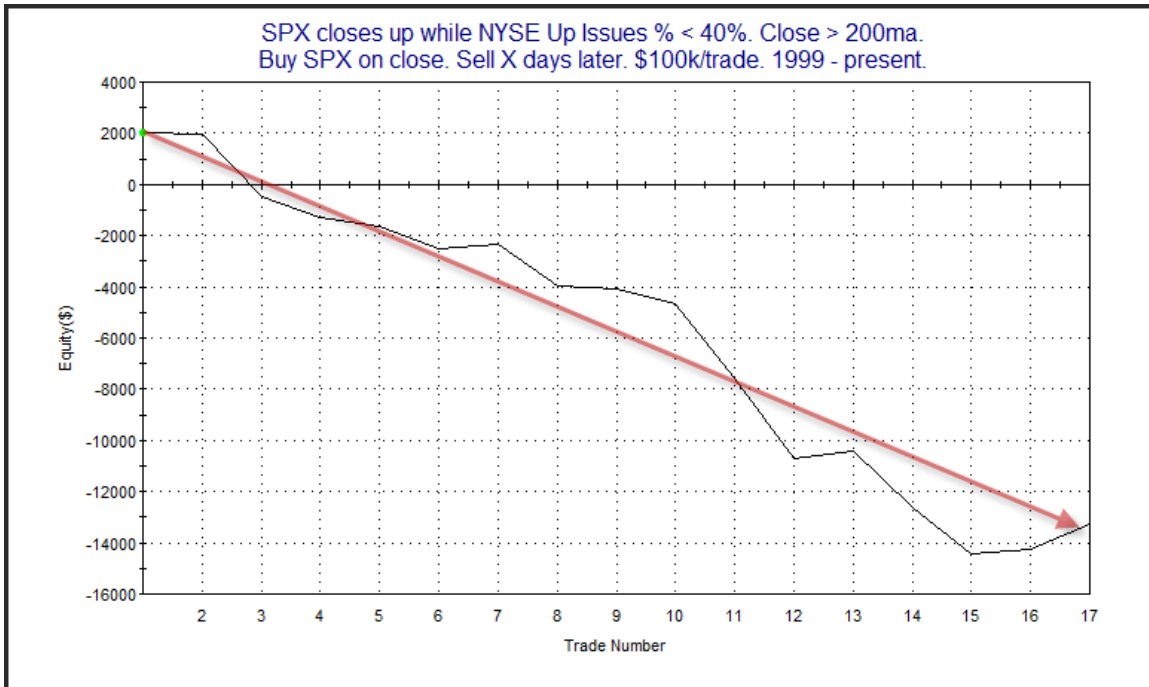
The market did a lot of wiggling Monday but ultimately got nowhere. The SPX gained 0.1%, the Nasdaq fell 0.15%, and the Russell 2000 dropped 0.3%. Breadth was weak as the NYSE Up Issues % came in at a mere 39% and the Up Volume % was 47%. Total volume dipped below Friday's levels.

Action today was not encouraging for the bulls, and in fact tonight's studies very nearly flipped the Aggregator value to negative.

One potential negative was the very weak breadth. In the 12/9/10 Subscriber Letter I looked at other instances where the SPX closed higher while the Up Issues % came in under 40%. Results below the 200ma had some large outliers and were somewhat inconsistent. Results above the 200ma showed a much more steady and persistent downside edge. Below I have updated the results for those instances that occurred above the 200ma.

SPX closes up while NYSE Up Issues % < 40%. Close > 200ma. Buy SPX 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	-7,877.86	17	8	9	47.06	997.31	-1,761.82	0.57	0.50	-463.40
4	-10,562.19	17	7	10	41.18	947.38	-1,719.39	0.55	0.39	-621.31
3	-13,260.28	17	5	12	29.41	733.44	-1,410.62	0.52	0.22	-780.02
2	-10,683.36	17	8	9	47.06	595.32	-1,716.21	0.35	0.31	-628.43
1	-4,839.67	17	6	11	35.29	1,051.68	-1,013.61	1.04	0.57	-284.69

The numbers here appear to suggest a solid downside edge. Now let's take a peek at the equity curve.



Despite the last 2 instances showing slight moves higher the downside edge appears intact

But it wasn't just NYSE breadth that was weak. Nasdaq breadth was also quite weak. The study below is from the 7/7/09 Subscriber Letter and the stats have been updated.

NYSE Up Issue % and Nasdaq Up Issue % < 40%. SPX closes higher.  
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	-12,807.30	11	4	7	36.36	2,066.09	-3,010.24	0.69	0.39	-1,164.30
4	-18,617.92	11	2	9	18.18	1,586.30	-2,421.17	0.66	0.15	-1,692.54
3	-12,361.36	12	4	8	33.33	1,698.61	-2,394.48	0.71	0.35	-1,030.11
2	-12,839.60	12	6	6	50.00	934.84	-3,074.77	0.30	0.30	-1,069.97
1	-11,317.82	12	2	10	16.67	955.02	-1,322.79	0.72	0.14	-943.15

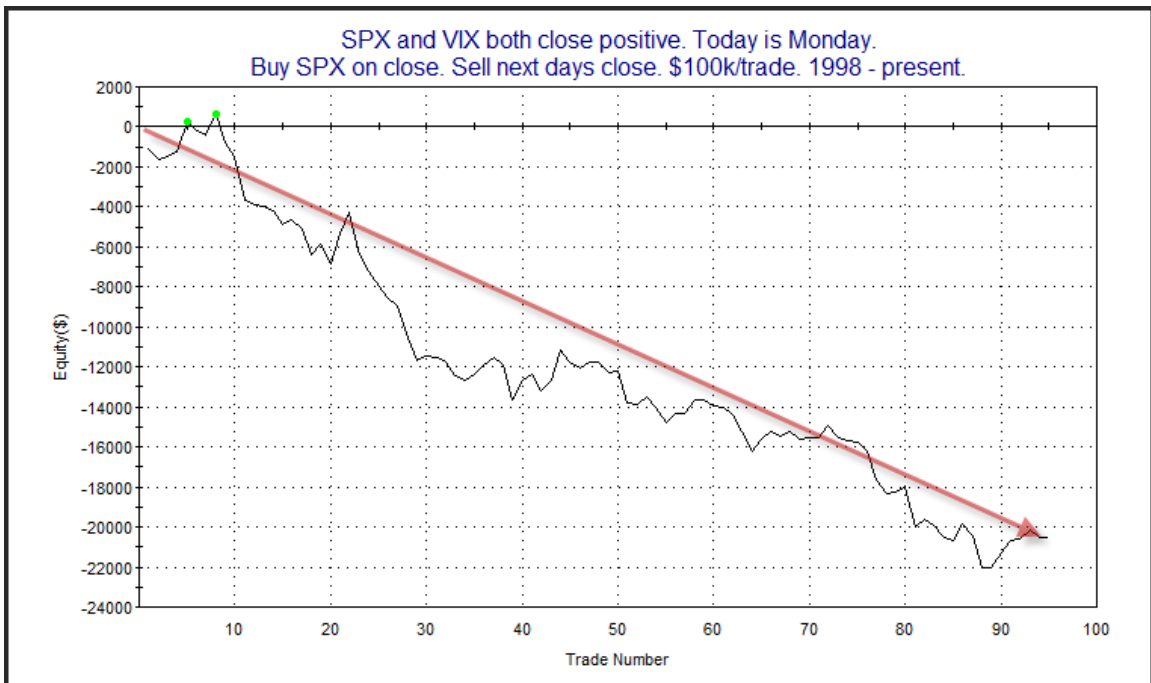
This has a lower sample size and is less consistent than the 1<sup>st</sup> study but it serves as further confirmation that the weak breadth appears to be short-term troublesome.

I've been looking for the VIX to pop a bit before putting on the last part of my index trade. Today was an odd day. The VIX finally had a small pop, which managed to trigger the XIV purchase in the trade ideas section, but it still doesn't appear stretched. It is only 8% above its 10-day moving average. Strange about the rise in the VIX Monday was that it was accompanied by a rise in the SPX as well. One quirk with the VIX is that it has a tendency to fall on Fridays and rise on Mondays. Therefore this setup is more common on Mondays than any other day of the week. This condition was last present and discussed in the 4/5/11 subscriber letter. I've again updated the study below.

**SPX and VIX both close positive. Today is Monday.**  
**Buy SPX on close. Sell X days later. \$100k/trade. 1998 - 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	-2,000.20	92	47	45	51.09	1,453.90	-1,562.97	0.93	0.97	-21.74
4	-7,664.21	95	46	49	48.42	1,253.82	-1,333.47	0.94	0.88	-80.68
3	-13,034.52	95	46	49	48.42	993.30	-1,198.50	0.83	0.78	-137.21
2	-17,687.28	95	43	52	45.26	712.62	-929.42	0.77	0.63	-186.18
1	-20,522.76	95	38	57	40.00	469.09	-672.77	0.70	0.46	-216.03

This appears to suggest a 1-day edge. Below is the equity curve so you can see how it has played out over time.



The edge here has been pretty consistent over the years.

I have updated the [Aggregator](#) chart below.



The green Aggregator Line came extremely close to dipping below 0 on Monday. Still, it remained positive as net expectations are now for slight upside over the next few days. Meanwhile, the black Differential Line is also extended above 0. Readings above 0 mean the SPX has underperformed expectations over the last few days. So net expectations are slightly positive 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 remained long at the close.

The green Aggregator line is again set to close above 0 on Tuesday. This could change if strong bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,297.95. This is about 2% above Monday's close. So we will either need a very strong day on Tuesday or a multi-day rally at this point in order for the Aggregator System to come off the buy signal.

I added some small positions on Monday but still have not put on the last bit of the index trade. While it is tempting to do so and it would lower my overall average cost in the index position, I am still holding out. The CBI did not budge and the move up in the VIX was very tame. I want to see at least one of them spike before getting 100% long. So for now I will simply manage my open long positions.

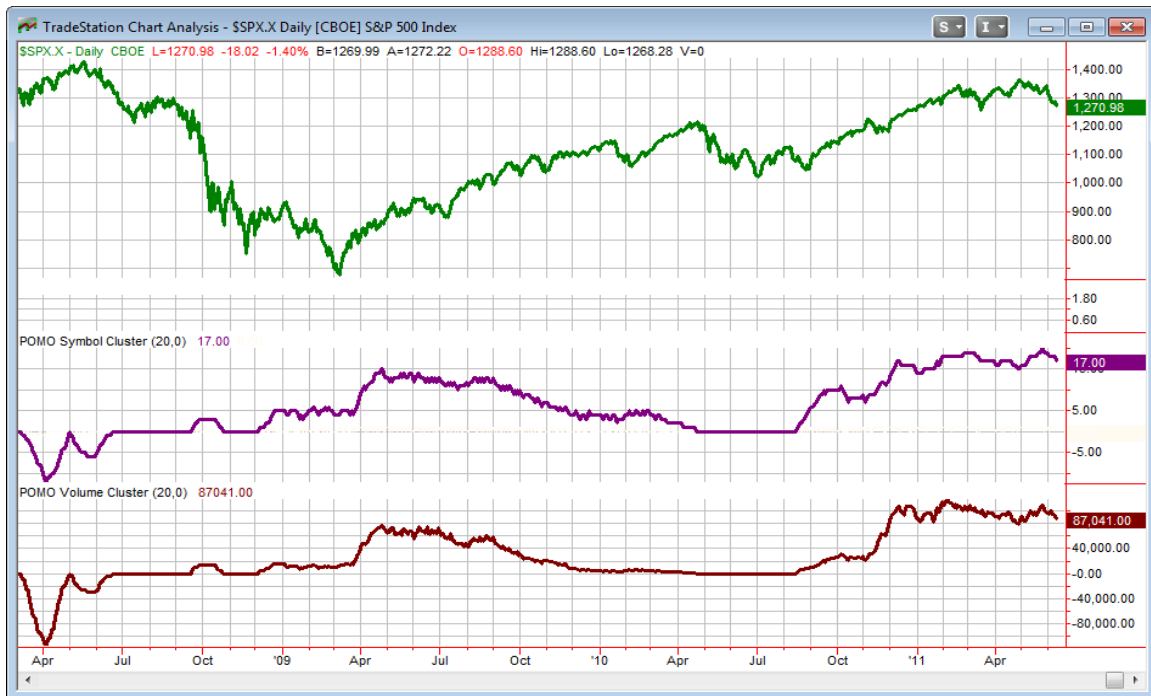
***Intermediate-term Outlook (2 weeks – 2 months)– updated 6/13 – neutral***

It was another tough week in the market. We are now down 6 weeks in a row. Perhaps the biggest development is that the POMO schedule was released on Friday and we can now see the end of QE2.

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 at high levels. Still, they are beginning to trend lower. The current schedule calls for steady buying until the end of the month, but after that there will be little in the way of Fed stimulus. Starting July 1 we will see these indicators begin to head back towards the 0 line. There are 2 small days of buying currently scheduled in July which is associated with the reinvestment of principal payments rather than the \$600billion of QE2 money. The past few times POMO stimulus was halted, it took the market about a month after the halt until prices began to decline.

For those that would like to view the current schedule I have provided a link below.

[http://www.newyorkfed.org/markets/tot\\_operation\\_schedule.html](http://www.newyorkfed.org/markets/tot_operation_schedule.html)

Intermediate-term studies are still slightly in favor of the bulls, but that may not last long with POMO exiting the equation. The bears may also point to the divergence in the number of new highs in the NYSE that I discussed a couple of weeks ago. The studies found on the intermediate-term active list at the top of this letter consider breadth, momentum, and intermediate-term mean reversion. I expect we will get a bounce here in the short-term as suggested by the short-term section above. That bounce could carry forward for another few weeks. I don't have great confidence that it will surpass the May highs. After the next few weeks the picture becomes less clear in my eyes. I'm moving the intermediate-term outlook to neutral. I will approach both longs and shorts with some caution but at this point I am willing to bet either way should short-term evidence suggest an edge.

## Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

### **Open Catapult Triggers**

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)

BRK.B – 1/3 position @ \$74.33

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

None

### **Broad Market Large Cap CBI – 5(3)( LOW(3), AEP, BRK.B)**

## 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.*

## Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	6/2/2011	\$131.87	\$127.70	-3.16%		Aggregator
SPY(1/4)	6/3/2011	\$130.15	\$127.70	-1.88%		Aggregator
LOW(1/3)	6/3/2011	\$23.18	\$22.05	-4.87%		Catapult
LOW(1/3)	6/6/2011	\$23.07	\$22.05	-4.42%		Catapult
AEP(1/3)	6/6/2011	\$37.43	\$37.13	-0.80%		Catapult
SPY(1/4)	6/6/2011	\$129.04	\$127.70	-1.04%		Aggregator
LOW(1/3)	6/8/2011	\$22.72	\$22.05	-2.95%		Catapult
<b>BAC(1/3)</b>	<b>6/9/2011</b>	<b>\$10.54</b>	<b>\$10.89</b>	<b>3.32%</b>		<b>sold on open</b>
BRK.B(1/3)	6/13/2011	\$74.10	\$74.29	0.26%		bought on open
XIV	6/13/2011	\$170.38	\$170.38	0.00%		bought on close

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