

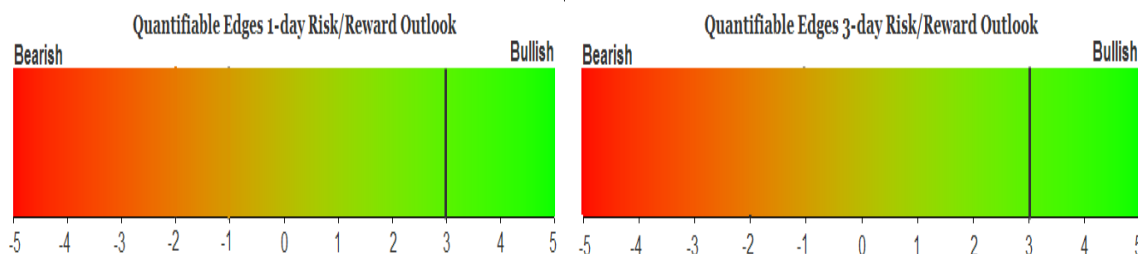
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 16, 2011

Volume 4 Issue 115

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- The VIX spike at an SPX 50-day low is suggestive of a short-term bounce.
- The large amount of numbered-system triggers is also supportive.

## Short-term Outlook

### The Bottom Line

A sharp decline put the market squarely oversold once again and triggered more bullish studies. While the market continues to act in a historically abnormal manner, there still appears to be a short-term upside edge.

## 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 16, 2011	SPX 50-low. VIX spike.	1-2 days	Bullish	2.80%
June 15, 2011	SPX up 2 days, below close 3 days ago.	1-3 days	Bullish	
June 14, 2011	NYSE Up Issues % < 40%. SPX up.	1-3 days	Bearish	
June 13, 2011	McClellan Osc % Rank < 2%. SPX 50 low	1-6 days	Bullish	3.70%
<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 3, 2011	Dn 2 days(early month & big/small drop)	1-9 days	Bullish	

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

## The Evidence

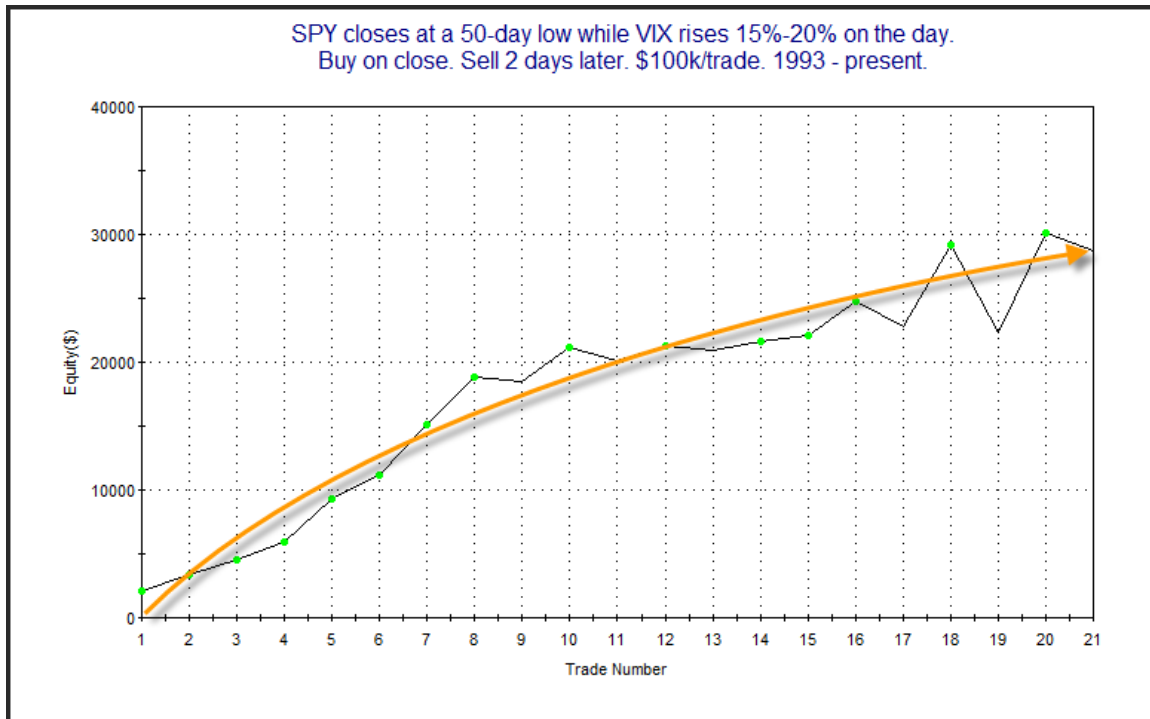
Despite a preponderance of evidence suggesting a short-term upside edge, the market got pounded on Wednesday. News from Greece seemed to be the main culprit sparking the selloff. Losses were strong across the board as the SPX, Nasdaq, and Russell 2000 all lost between 1.7% - 1.85%. Breadth was also strongly negative as the NYSE Up Issues % came in at 16% and the Up Volume % was just 8%. Total NYSE volume rose to the highest level of the last few days.

The market had been drifting steadily lower for the past 2 weeks without any sign of panic. I warned that we might have to see such a sign before the market could put in a short-term bottom. And while I've been hoping panic wouldn't arrive, I've been holding out on the last lot of my index trade until we saw a spike in the CBI above 10 or a spike in the VIX. Wednesday's decline was finally accompanied by a VIX spike. It rose 16.8% today, which led me to concoct the following study.

SPY closes at a 50-day low while VIX rises 15%-20% on the day. 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	All: Max Losing Trade	All: Max Winning Trade
5	27,320.20	20	12	8	60.00	2,860.56	-875.81	3.27	4.90	1,366.01	-3,214.98	11,238.92
4	17,285.78	21	16	5	76.19	2,376.14	-4,146.50	0.57	1.83	823.13	-15,473.88	10,630.48
3	25,311.56	21	16	5	76.19	2,718.11	-3,635.63	0.75	2.39	1,205.31	-13,375.08	6,933.92
2	28,672.34	21	15	6	71.43	2,718.42	-2,017.32	1.35	3.37	1,365.35	-6,878.34	7,714.56
1	5,321.69	21	13	8	61.90	1,397.00	-1,604.92	0.87	1.41	253.41	-4,474.26	2,965.22

**20 of 21 instances (95%) closed above the entry price at some point in the next week. The lone failure occurred on 10/6/2008.**

As you can see, panic entering when the market is hitting new lows has almost always led to a short-term bounce. Below is an equity curve using a 2-day exit strategy.



While the edge may be cooling off a bit, the study certainly appears to favor a quick bounce.

A number of studies from the 6/13 letter just a couple of days ago triggered in the Quantifinder. A few of the more interesting ones were related to the unfilled gap down in the SPY on Wednesday. I have copied below an excerpt from that letter. (Studies are not updated.)

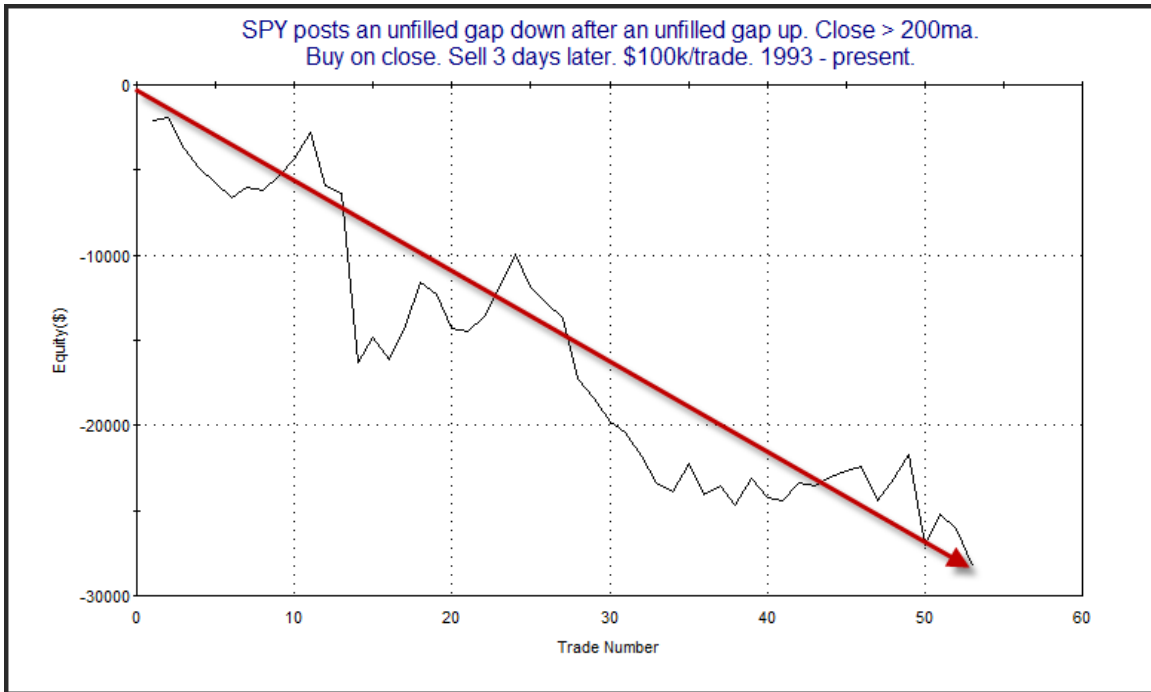
*Lastly, below I am going to share some additional studies that appeared in the Quantifinder. Individually they appear to suggest an edge. But they all look at the SPY price pattern and Friday's unfilled gap, and the 1<sup>st</sup> set is bearish while the 2<sup>nd</sup> set appears bullish. Therefore, while I found these tests individually compelling, I decided due to the conflict among them that I would not include any of them on the Active Studies list. Still, I thought they were worth examining in case subscribers opinions differed than my own and you elected to incorporate some of them in your thinking.*

*This first group of studies is from the 5/12/11 Subscriber Letter. I have updated the results below.*

SPY posts an unfilled gap down after an unfilled gap up. Close > 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	-16,944.92	51	21	30	41.18	1,554.78	-1,653.18	0.94	0.66	-332.25
4	-11,604.59	52	22	30	42.31	1,398.45	-1,412.35	0.99	0.73	-223.17
3	-28,252.96	53	21	32	39.62	1,193.48	-1,666.12	0.72	0.47	-533.07
2	-21,203.33	54	22	31	40.74	863.05	-1,296.47	0.67	0.47	-392.65
1	-198.48	54	26	27	48.15	673.75	-656.14	1.03	0.99	-3.68

*These results would suggest a short-term bearish edge. Using the 3-day exit strategy I ran an equity curve to see how consistent the edge has been.*



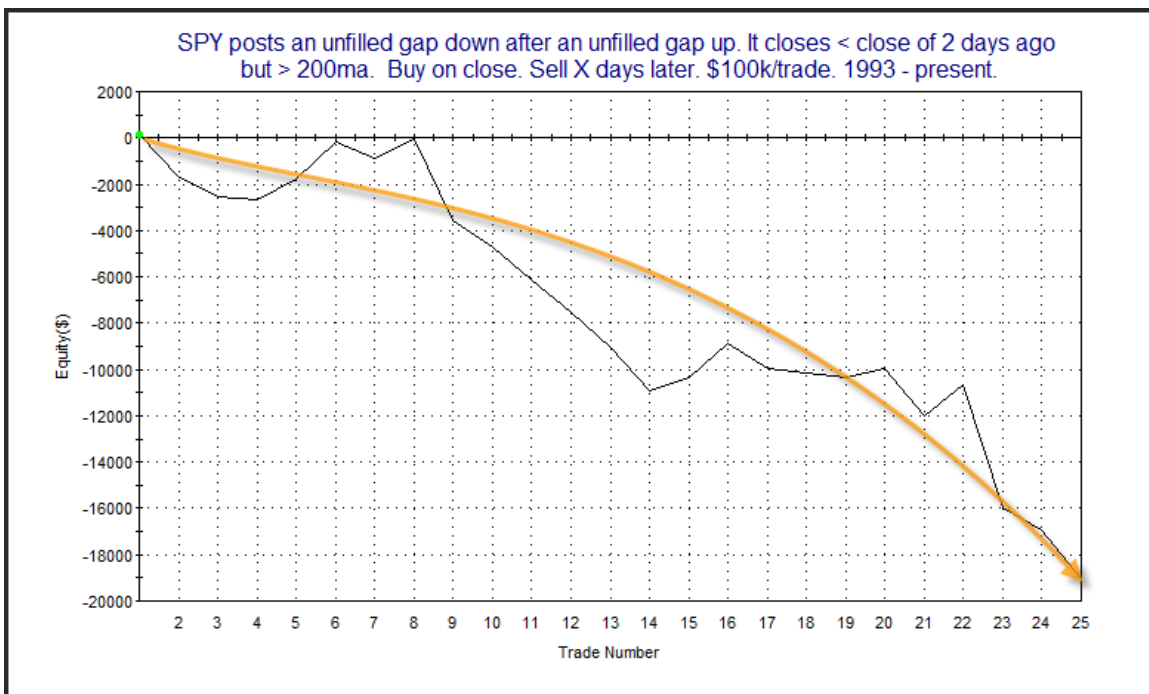
*Certainly returns have been choppy, but it's at new lows and the trend down has been in place a very long time. On 5/12 I also wondered whether the fact that the gap down day was more powerful than the gap up day would make any difference. So I filtered the test 1 more time to only include those instances where the SPY closed below the close of 2 days ago (meaning the down day lost more than the up day gained). Those results are below.*

SPY posts an unfilled gap down after an unfilled gap up. It closes < close of 2 days ago 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	-7,482.99	24	9	15	37.50	1,389.50	-1,332.57	1.04	0.63	-311.79
4	-5,695.82	24	10	14	41.67	1,251.96	-1,301.10	0.96	0.69	-237.33
3	-19,068.23	25	8	17	32.00	898.89	-1,544.67	0.58	0.27	-762.73
2	-16,890.06	25	7	17	28.00	728.39	-1,293.46	0.56	0.23	-675.60
1	-665.02	25	11	13	44.00	547.95	-514.81	1.06	0.90	-26.60

22 of 25 instances (88%) close below the entry price at some point in the next week.

Results here didn't change dramatically. They appear just slightly more bearish than the first set of results. Below is the equity curve using a 3-day exit strategy.



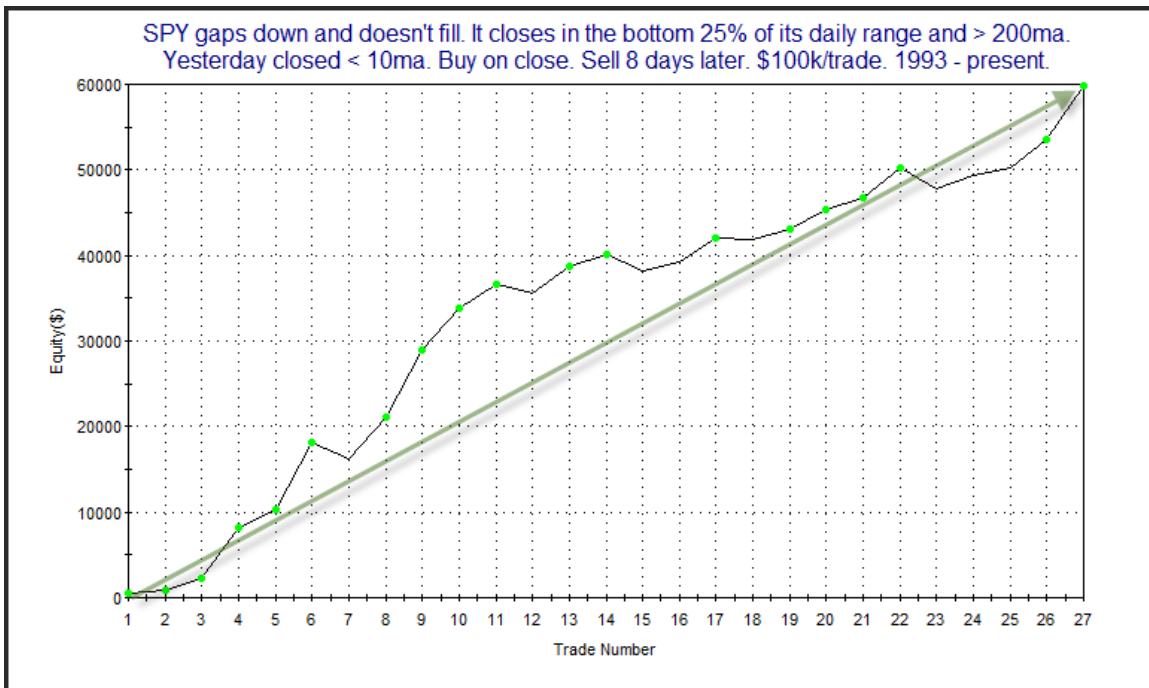
Again the curve appears to confirm the downside edge suggested by the stats table.

But another study from the 12/18/09 subscriber letter brought the above results into question in my mind. That study is shown below.

SPY gaps down and doesn't fill. It closes in the bottom 25% of its daily range and > 200ma.  
 Yesterday closed < 10ma. 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	55,813.25	26	20	6	76.92	3,038.67	-826.70	3.68	12.25	2,146.66
9	58,480.94	27	22	5	81.48	2,806.29	-651.50	4.31	18.95	2,165.96
8	59,900.91	27	22	5	81.48	3,067.00	-1,514.63	2.02	8.91	2,218.55
7	53,228.91	27	22	5	81.48	2,824.84	-1,783.51	1.58	6.97	1,971.44
6	43,289.67	27	19	8	70.37	2,850.56	-1,358.88	2.10	4.98	1,603.32
5	37,940.50	27	18	9	66.67	2,680.85	-1,146.10	2.34	4.68	1,405.20
4	31,113.10	29	20	9	68.97	2,087.84	-1,182.64	1.77	3.92	1,072.87
3	29,081.61	30	22	8	73.33	1,773.85	-1,242.89	1.43	3.92	969.39
2	28,222.25	30	24	6	80.00	1,520.20	-1,377.09	1.10	4.42	940.74
1	21,343.69	30	23	7	76.67	1,114.35	-612.34	1.82	5.98	711.46

The gap down and selloff here appear to suggest an immediate and substantial upside edge. Below is an equity curve assuming an 8-day hold.



Equity curves don't look much stronger and steadier than this. I decided tonight to also see whether the edge held up if the pattern appeared at a 50-day low.

SPY gaps down and doesn't fill. It closes in the bottom 25% of its daily range and at a 50-day low. 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	56,738.26	36	22	14	61.11	5,422.94	-4,469.03	1.21	1.91	1,576.06
9	55,348.73	36	26	10	72.22	4,654.50	-6,566.82	0.71	1.84	1,537.46
8	59,873.43	36	26	10	72.22	4,485.26	-5,674.33	0.79	2.06	1,663.15
7	54,153.96	36	25	11	69.44	4,010.67	-4,192.06	0.96	2.17	1,504.28
6	57,900.68	37	27	10	72.97	3,742.51	-4,314.72	0.87	2.34	1,564.88
5	45,760.36	37	24	13	64.86	3,590.18	-3,108.00	1.16	2.13	1,236.77
4	23,728.02	39	21	18	53.85	3,261.51	-2,486.87	1.31	1.53	608.41
3	30,372.07	41	26	15	63.41	2,467.70	-2,252.55	1.10	1.90	740.78
2	22,964.54	42	21	21	50.00	2,751.15	-1,657.60	1.66	1.66	546.77
1	11,640.04	43	24	19	55.81	1,608.66	-1,419.36	1.13	1.43	270.70

*While not quite as strong as the previous test, there certainly seems to be an upside edge under these circumstances as well.*

*As I indicated above, due to the conflicting nature of these SPY studies I did not include any of them in the Aggregator. It will be interesting to see how they play out over time. Of course the overall weight of the evidence is strongly bullish no matter how I lay it out.*

On another note, Wednesday's selloff triggered a huge amount of numbered systems tonight, which can be found on the spreadsheet (located on the systems page). Generally, when there are a large number of individual stocks and ETFs all triggering at the same time, that is often a pretty good sign that the market as a whole is ready to bounce. One notable trigger was that SPY triggered system 80402. I ran a performance report to see how SPY has fared in the past based on 80402.

SPY "system 80402".  
\$100k/trade. 1993 - present.

TradeStation Performance Summary

Collapse ^

All Trades

Total Net Profit	\$10,415.61	Profit Factor	4.14
Gross Profit	\$13,736.03	Gross Loss	(\$3,320.42)
Total Number of Trades	12	Percent Profitable	75.00%
Winning Trades	9	Losing Trades	3
Even Trades	0		
Avg. Trade Net Profit	\$867.97	Ratio Avg. Win:Avg. Loss	1.38
Avg. Winning Trade	\$1,526.23	Avg. Losing Trade	(\$1,106.81)
Largest Winning Trade	\$3,472.56	Largest Losing Trade	(\$2,631.14)

Results here are impressive.

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



The green Aggregator Line is once again solidly above 0. Readings above 0 mean net expectations from the active list are for upside over the next few days. Meanwhile, the black Differential Line is also well above 0. This means the SPX has underperformed expectations over the last few days. So net expectations are positive and the SPX is oversold versus recent expectations. While the last 2 weeks have been rough, 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 Thursday. This could change if strong bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,278.52. This is about 1% above Wednesday's close. So it would take a strong move higher on Thursday to see the Differential line fall into negative territory.

Today was especially frustrating since the market had put in a decent bounce on Tuesday and was so close to signaling an exit for my open long positions. Aggregator signals rarely last this long. I discussed this in Sunday's letter. We have now reached a point where only 2 other Aggregator buy signals have lasted this amount of time. And while the SPY is still down less than 4% from its first entry, it can feel a lot worse than that when you've been locked in a swing trade for so long. Below is an excerpt from the 3/17/11 Subscriber Letter. What I wrote then echoes my feelings today as well.

*Fear is not only palpable when looking at the sharpness of the intraday selloffs or the VIX, but I have also heard from many traders and subscribers who are deeply concerned about the selloff. Often times the most difficult trades are the ones that end a nice winning streak. Even with a solid bounce from here there's a decent chance that many of the current trade ideas will finish in the red. But let's not lose perspective on the long term, and let's also not lose perspective on the present. It's very easy to get emotional when your position is going against you. This is especially true when the TV is constantly discussing dire news stories and the market is suffering multiple down days. From a personal standpoint, I have endured selloffs far worse than what has occurred in the last week or so. Even so, I too feel frustration and anxiety when watching my position go against me and seeing the things going on in the world.*

*It's very important not to make rash decisions on positions. This means don't get scared out of them and don't get sucked in to taking on too much leverage because you're trying to make up for unrealized losses. I make most of my decisions at night. Rarely will I adjust a large position during the day unless I have already thought it through the night before. For me the nightly research is cleansing and allows me the opportunity to step back and take an objective view of the market each and every night while it is closed. By doing so I am able to devise and execute a plan with a clear head and in an optimal manner. I would strongly suggest to all traders that they have a plan each day before*

*they go into the day, and that they follow that plan. By trading with a clear head you will be able to maintain a more objective perspective.*

*And while the present selloff and situation "feels" tough, the actual damage to this point isn't that large. Even if someone were to trade the Aggregator System using an "all in" methodology, the current signal was only down 4% as of Wednesday's close. Obviously I expect the trade will close out better than a 4% loss (or I wouldn't still be in it), but even if it falls farther from here and ends up bouncing back and closing out with a 4% loss, that still isn't a huge loser. It's a loss that could be overcome with just a couple of good trades. It's frustrating to have profits eaten into and it's frustrating to suffer drawdown, but dealing with drawdown is just part of trading. So if you're feeling "stuck long", don't despair. Trade consistently and with an edge and in the long run you'll be fine.*

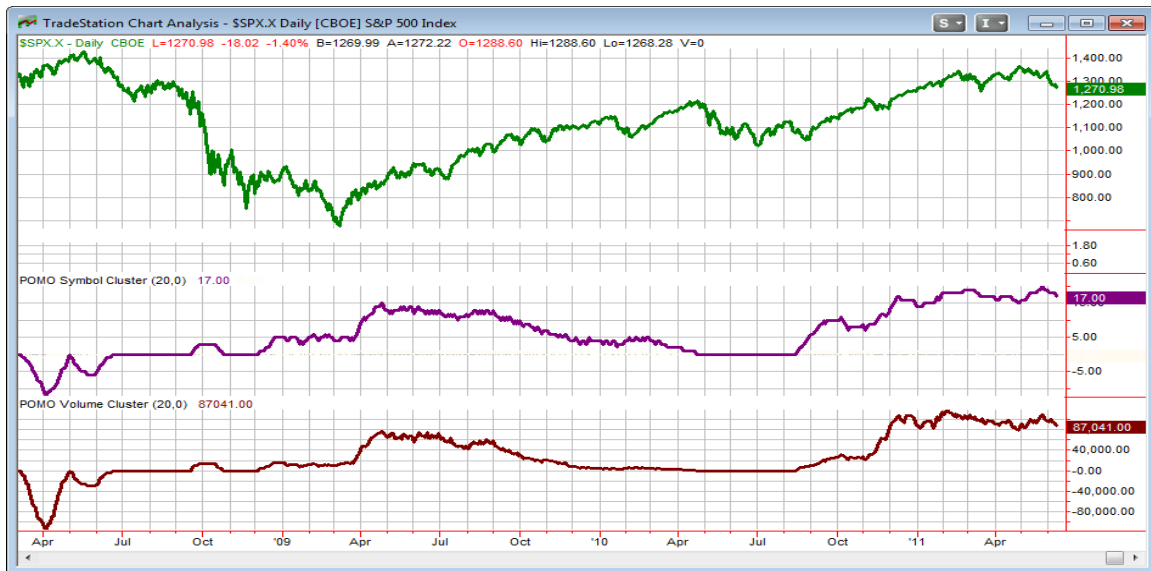
***Intermediate-term Outlook (2 weeks – 2 months)– updated 6/13 – neutral***

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)

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

None

### **Broad Market Large Cap CBI – 4(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.

**SPY – buy ¼ index position at \$127.02** – Based on short-term outlook above. I am looking to put on the last part of my index position in anticipation of a bounce.

### Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	6/2/2011	\$131.87	\$127.02	-3.68%		Catapult
SPY(1/4)	6/3/2011	\$130.15	\$127.02	-2.40%		Catapult
LOW(1/3)	6/3/2011	\$23.18	\$22.11	-4.62%		Catapult
LOW(1/3)	6/6/2011	\$23.07	\$22.11	-4.16%		Catapult
AEP(1/3)	6/6/2011	\$37.43	\$36.93	-1.34%		Catapult
SPY(1/4)	6/6/2011	\$129.04	\$127.02	-1.57%		Aggregator
LOW(1/3)	6/8/2011	\$22.72	\$22.11	-2.68%		Catapult
<b>BRK.B(1/3)</b>	<b>6/13/2011</b>	<b>\$74.10</b>	<b>\$74.76</b>	<b>0.89%</b>		<b>sold on open</b>
XIV	6/13/2011	\$170.38	\$160.81	-5.62%		

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