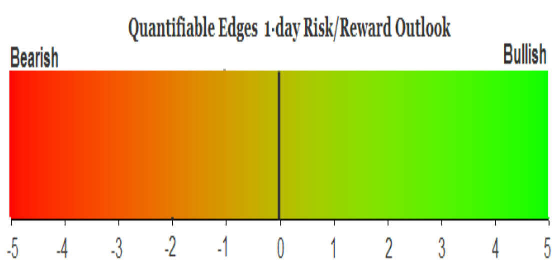
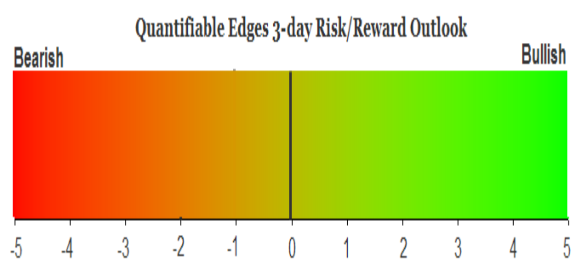
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 21, 2011 Volume 4 Issue 118

Market Overview





Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Flat	50% Long XIV	Flat	Flat

Tonight's Research Points

- SPX up 3 days but below the close of 4 days ago is often followed by more upside.
- Wednesday is a Fed Day. One factor in determining the Fed Day edge is where in the range the SPY closes the day before.
- The very low 3/10 Offset HV reading suggests a big move could be on tap in the next few days.

Short-term Outlook

The Bottom Line

The Aggregator is back to neutral. Tuesday is unclear, but if it does pull back that could set up a nice entry ahead of Wednesday's Fed Day. I'll look to exit most everything in the morning and then perhaps take some exposure back on as we approach the close.

Hanna Capital Management, LLC 16 Hillcrest Rd., Medfield, Massachusetts 02052 781-956-6952

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
June 21, 2011	U 3 below 4 ago.	1 day	Bullish	
June 20, 2011	SPX up 2 days, below close 3 days ago.	1-3 days	Bullish	1.60%
June 17, 2011	VIX up 6% while SPX up.	1-3 days	Bullish	
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	POMO	int term	weakening	
October 25, 2010	SPX Golden Cross	int term	Bullish	
Dropped Tonight				
June 17, 2011	Breadth < 45%. Up day after 1.5% drop,	1-2 days	Bearish	
June 13, 2011	McClellan Osc % Rank < 2%. SPX 50 low	1-6 days	Bullish	3.70%

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

The Evidence

After gapping down a bit to start the day the market rallied throughout the morning. The afternoon action was quiet. Gains were not added to, but were maintained well. In the end the SPX and Nasdaq closed up 0.5% while the Russell 2000 gained 0.85%. Breadth was solidly positive as the NYSE Up Issues % came in at 68% and the Up Volume % was 70%. Total NYSE volume came in at the lightest level so far in June.

One study from the Quantifinder tonight that I thought was worth revisiting was last shown in the 4/18/11 Subscriber Letter. It looked at 3-day rallies that could not overcome the 1-day drop that occurred 4 days ago. I have updated the results below.

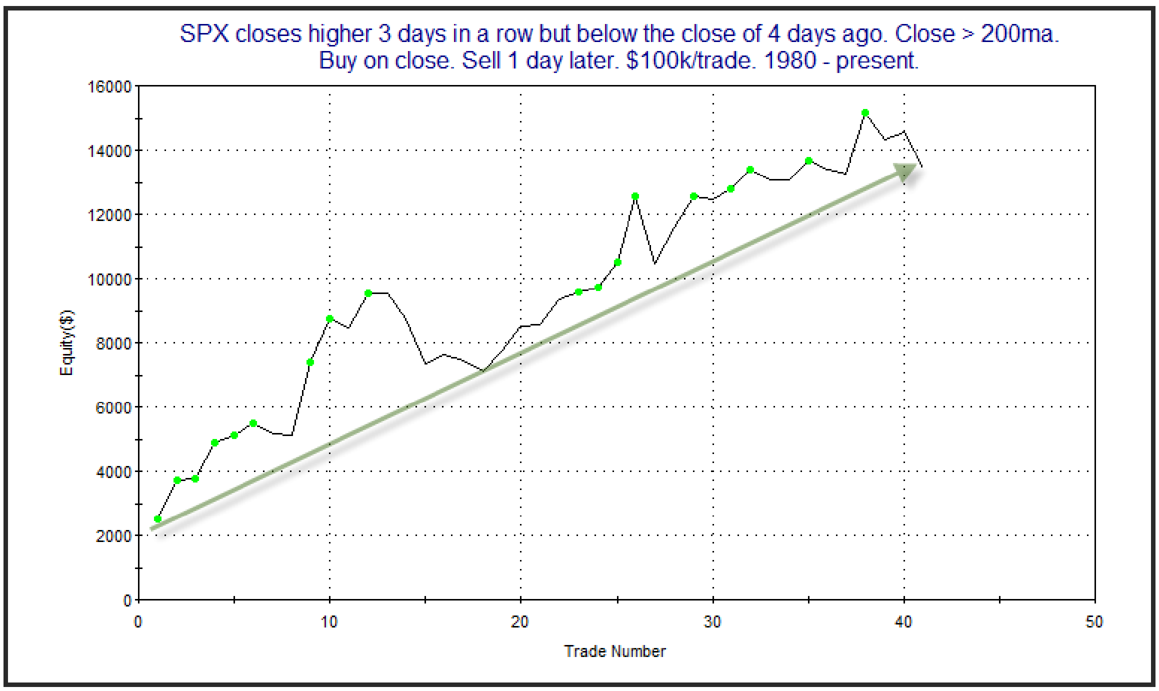
SPX closes higher 3 days in a row but below the close of 4 days ago. Close > 200ma.
Buy on close. Sell X days later. $100k/trade. 1980 - present.

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	16,891.01	41	23	18	56.10	1,817.14	-1,383.51	1.31	1.68	411.98
4	20,520.25	41	28	13	68.29	1,543.71	-1,746.43	0.88	1.90	500.49
3	12,978.88	41	24	17	58.54	1,502.39	-1,357.56	1.11	1.56	316.56
2	13,303.29	41	26	15	63.41	1,059.47	-949.54	1.12	1.93	324.47
1	13,444.39	41	26	14	63.41	834.20	-588.92	1.42	2.63	327.91

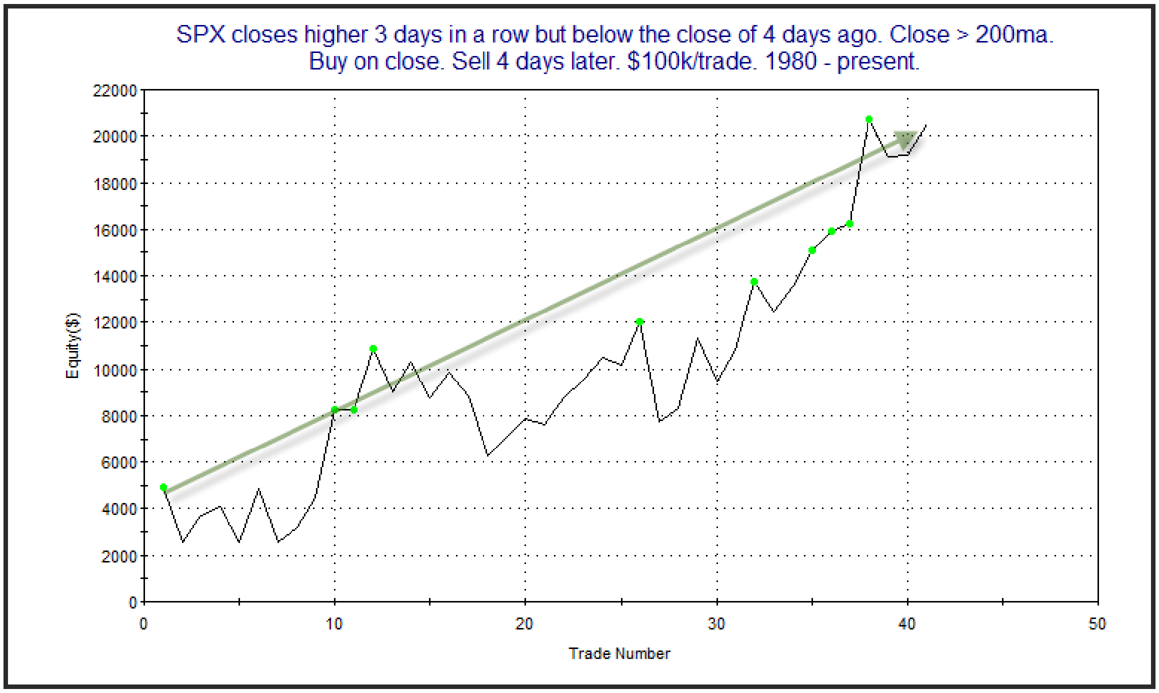
I found it interesting that despite the fact the market had already risen for 3 days in a row, the fourth day showed gains nearly 2/3 of the time. This even held true over the 1-4 day period, although most of the gains were realized on day 1.

I also broke this study down a few different ways to see if it mattered that it was coming off an intermediate-term low. I filtered using a 50-day low (and eliminated to 200ma filter) and found only 4 instances. They were all higher 4 days later but 2 of them rose less than 0.1%. I also looked at 20-day lows above the 200ma occurring 3 days back. The results here fell very much in line with these results above – both in terms of winning % and average gain. The filtering therefore did not help, but it didn't hurt the cause either.

To see how this potential edge has played out over time I ran an equity curve using a 1-day hold.



Despite 2 recent failures the equity curve appears fairly steady and solid. Below I also ran the 4-day equity curve.



Similar to the 1st curve the upside edge has appeared to persist for a while.

One notable seasonal influence is that Wednesday is a Fed Day. I wrote a short book about a year ago titled "The Quantifiable Edges Guide to Fed Days". In it I looked in great detail at edges that appeared on and around Fed Days. One of the studies I showed in the book looked at Fed Day performance based on where the day before the Fed Day closed within its range. Below is an excerpt from the Guide. (It begins on page 32.) I have updated all of the results in the below excerpt.

Below I broke out Fed Day performance by what quartile the closing price fell in the day before the Fed Day. First let's look at the top quartile.

SPY closes in top 25% of daily range. Tomorrow is a Fed Day.
Buy on close. Sell Fed Day close. $100k/trade. 3/1/93 - present.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$8,912.46	Profit Factor	1.53
Gross Profit	$25,823.29	Gross Loss	($16,910.83)
Total Number of Trades	58	Percent Profitable	50.00%
Winning Trades	29	Losing Trades	27
Even Trades	2		
Avg. Trade Net Profit	$153.66	Ratio Avg. Win:Avg. Loss	1.42
Avg. Winning Trade	$890.46	Avg. Losing Trade	($626.33)
Largest Winning Trade	$2,238.25	Largest Losing Trade	($2,739.69)

This quartile boasts nearly twice as many instances as any of the others. I suspect this is because the market often gets bid up in the afternoon in anticipation of the next day's Fed announcement. What you'll find is that while the results are positive here, they are weaker than any other quartile. Next is the 2nd quartile which means a finish in the top 50% but not the top 25% of the daily range.

SPY closes > 50% and <= 75% of daily range. Tomorrow is a Fed Day.
Buy on close. Sell Fed Day close. $100k/trade. 3/1/93 - present.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$10,819.50	Profit Factor	1.92
Gross Profit	$22,545.77	Gross Loss	($11,726.27)
Total Number of Trades	32	Percent Profitable	56.25%
Winning Trades	18	Losing Trades	13
Even Trades	1		
Avg. Trade Net Profit	$338.11	Ratio Avg. Win:Avg. Loss	1.39
Avg. Winning Trade	$1,252.54	Avg. Losing Trade	($902.02)
Largest Winning Trade	$4,704.07	Largest Losing Trade	($2,246.40)

The win rate is only marginally better but the profit factor and average trade improve quite a bit here. Now let's look at the 3rd quartile.

SPY closes > 25% and <= 50% of daily range. Tomorrow is a Fed Day.
Buy on close. Sell Fed Day close. $100k/trade. 3/1/93 - present.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$10,501.80	Profit Factor	2.60
Gross Profit	$17,070.96	Gross Loss	($6,569.16)
Total Number of Trades	25	Percent Profitable	72.00%
Winning Trades	18	Losing Trades	7
Even Trades	0		
Avg. Trade Net Profit	$420.07	Ratio Avg. Win:Avg. Loss	1.01
Avg. Winning Trade	$948.39	Avg. Losing Trade	($938.45)
Largest Winning Trade	$2,943.00	Largest Losing Trade	($2,066.62)

Here again we see the stats improve. The % profitable jumps up to 72% and the profit factor and average net profit also increase nicely. Lastly let's look at the bottom quartile.

SPY closes in bottom 25% of daily range. Tomorrow is a Fed Day.
Buy on close. Sell Fed Day close. $100k/trade. 3/1/93 - present.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$17,309.06	Profit Factor	5.74
Gross Profit	$20,959.35	Gross Loss	($3,650.29)
Total Number of Trades	31	Percent Profitable	77.42%
Winning Trades	24	Losing Trades	7
Even Trades	0		
Avg. Trade Net Profit	$558.36	Ratio Avg. Win:Avg. Loss	1.67
Avg. Winning Trade	$873.31	Avg. Losing Trade	($521.47)
Largest Winning Trade	$2,696.00	Largest Losing Trade	($1,141.01)

These are by far the strongest numbers. All of the stats are substantially better in this case. While strong closes before a Fed Day carry a mild bullish edge, it is the poor closes that provide a sizable advantage. It also appears that the worse the close the better the prospects for the following day.

So while these tests don't clue us in on how tomorrow will perform, they are important to keep in mind when considering Wednesday's action.

Also notable about current conditions is that the 3/10 Offset Historical Volatility Indicator came in at an extremely low 0.17 on Monday. I first introduced this indicator in July of 2009. It essentially takes a short 3-day measure of Historical Volatility and compares that to the 10-day measure of 3-days ago. Low readings indicate there has been a contraction in volatility. High numbers indicate there has been an expansion. Anything at or below 0.25 is regarded as extremely low. Often after sharp contractions like this we often see a volatility expansion take place. In August of 2009 I published a study that found this condition created a favorable environment for trading Opening Range Breakouts. A link to that study is below:

Quantifiable Edges ORBs Study.pdf

For anyone who is interested in seeing some techniques for actually trading these ORBs, there is a webinar from October 2010 on the subject on the videos page.

http://www.quantifiableedges.com/members/videos.php

It's important to note that the 3/10 Offset HV indicator predicts volatility, not direction. For direction I look to the Aggregator. The Aggregator is currently in a neutral position. Normally this would mean if the right setup appeared in the morning I'd likely be willing to take a trade in either direction – but with a more conservative position size than if the Aggregator was in agreement with the breakout. But tomorrow is the day before a Fed Day. Days before Fed Days are often tight in their range. Traders will frequently tighten up before a big announcement. Wednesday is much more likely to provide the range expansion than Tuesday. So in this particular case it is unlikely I will look to attempt an ORB trade.

Of further note, the 3/10 Offset HV Calculation is available as part of the new "QE Indicators/Functions for Tradestation". Subscribers may download it to include on their own charts. A link to the Indicators page is below, where you may download the User Guide or the Tradestation ELD.

http://www.quantifiableedges.com/members/qeindicators.php

I have updated the Aggregator chart below.

The green Aggregator Line is still 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 took a swift dip and is now below 0. This means the SPX has outperformed expectations over the last few days. So net expectations are positive but the SPX is already overbought versus recent expectations. This is considered a neutral configuration. Neutral configurations can be seen on the chart whenever both lines close on opposite sides of 0. Due to this the Aggregator System turned from long to flat 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 1,275.68. This is only about 0.2% below Monday's close. So for the Differential Line to rise back above 0 it would only take a mild pullback on Tuesday.

I'm feeling fairly neutral on Tuesday's action, but if the market pulls back I'm optimistic about the possibilities for Wednesday's Fed Day. I lightened up some at the close

Monday and will look to take almost everything off Tuesday morning. Depending on how Tuesday unfolds I may look to add some exposure back at the close in anticipation of a positive Fed Day. Details in the Trade Ideas section below.

Intermediate-term Outlook (2 weeks – 2 months)– updated 6/20 – neutral

The SPX closed higher this past week. In fact it closed higher on 4 of the 5 days. This sounds impossible since every day but Tuesday seemed disappointing, but it is true. From the 5/2 peak down to the low on Thursday the SPX declined 8.2%.

I conducted extensive research into IBD Follow-Through-Days (FTD) over the last few years. Much of it was published on the blog in 2008. Most of the work I published required an SPX correction of at least 8% before a FTD was looked for. Investors Business Daily followers and other intermediate-term trade will be eagerly awaiting a FTD before looking to aggressively allocate intermediate-term trend following positions to their portfolios.

That research is too vast to explore in detail in the letter, but I would suggest readers that are interested may want check out the links below.

This first one is a summary post with links to different areas of the research.

http://quantifiableedges.blogspot.com/2008/07/follow-through-days-quantified.html

This second link will bring up all blog posts with an "IBD Follow Through Day" label. There have been a few since the summary post above was published.

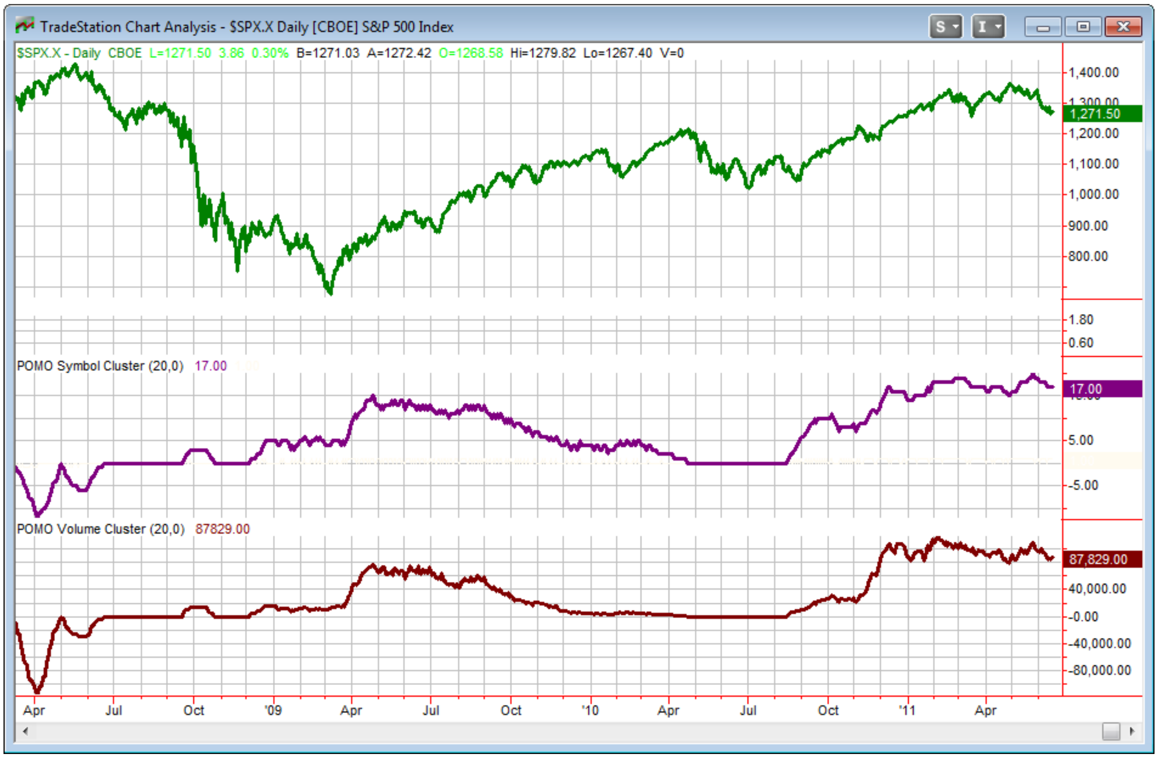
http://quantifiableedges.blogspot.com/search/label/IBD%20Follow%20Through%20Day

As bounces occur and FTDs are registered I will be sure to alert readers to odds and edges associated with FTDs.

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



My POMO interpretation remains the same as last week.

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

Intermediate-term studies are moderately bullish but we are certainly in the midst of a correction. Whether it turns into something worse or whether it straightens itself out quickly isn't yet clear. 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. My outlook remains neutral for now. This means I will approach both longs and shorts with some caution but 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

None

Catapult for ETF's Trades

None

***Broad Market Large Cap CBI* – 0**

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 if SPY closes in lower half of daily range. This is based on the Fed Day tendency to rally. I will be looking to exit this lot on Wednesday.

SPY – buy ¼ index position on SPX close <= 1,275.68 IF CURRENT SPY POSITIONS ARE EXITEDDURING THE DAY. A lower close would very likely trigger a new Aggregator long signal. I'd look to get in at the close – ahead of the Fed Day markup. If the exits for the current SPY positions are not hit, then I am not going to load the boat, but will just hold on to those positions.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	**6/2/2011**	**$131.87**	**$128.33**	**-2.69%**		**sold on close (div adj)**
SPY(1/4)	**6/3/2011**	**$130.15**	**$128.33**	**-1.40%**		**sold on close (div adj)**
LOW(1/3)	6/3/2011	$23.18	$23.11	-0.30%		sell on open
LOW(1/3)	**6/6/2011**	**$23.07**	**$23.11**	**0.17%**		**sold on close**
AEP(1/3)	**6/6/2011**	**$37.43**	**$37.64**	**0.56%**		**sold on close**
SPY(1/4)	6/6/2011	$129.04	$128.33	-0.55%		Dividend adjusted price
LOW(1/3)	6/8/2011	$22.72	$23.11	1.72%		sell on open
XIV	6/13/2011	$170.38	$162.00	-4.92%		
SPY(1/4)	6/16/2011	$127.02	$128.33	1.03%		Dividend adjusted price

One lot of LOW was exited at the close on Monday as per Sunday's night's letter. I will close out the other 2 lots on Tuesday's open.

I will also look to exit the remaining SPY lots at a limit price of $127.70 – which is Monday's close. (Not adjusted for the recent dividend.) If this is not hit in the 1st 30 minutes or so, I may look to adjust my exit strategy and either lower the limit or perhaps place a stop below the low of the day.

I will hold on to the XIV trade for now since I am expecting more upside in the next few days and the VIX:VXV ratio is back down below 0.95.