

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 24, 2011

Volume 4 Issue 121

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 large SPY gap down and partial reversal appear to suggest bullish inclinations.

Short-term Outlook

The Bottom Line

Evidence continues to point to the bulls. Meanwhile the SPX has now moved back to "oversold" versus recent expectations. This has triggered a long Aggregator signal. I don't completely trust it yet but am beginning to scale in to a long position.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
June 24, 2011	SPY 1% Gap Down & Partial Reversal	1-3 days	Bullish	2.30%
June 23, 2011	Fed Day new high then reverse down	1-3 days	Bullish	2.05%
June 22, 2011	FTD with Up Issues % 1-yr Rank > 95%	1-3 days	Bullish	2.10%
Active - Long Term				
June 22, 2011	FTD with Up Issues % 1-yr Rank > 95%	int term	Bullish	
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	

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

The Evidence

The market opened down big to start the day and the selling intensified after the open. Around 11am EST it managed to put in a low. It then chopped around for several hours before a last hour surge sparked by Greek refinancing news brought us to a mixed close. In the end the SPX lost 0.3% while the Nasdaq gained 0.7% and the Russell 2000 added on 0.35%. NYSE breadth was negative while Nasdaq breadth was positive. The NYSE numbers showed 42% Up Issues and 35% Up Volume. Total NYSE volume rose from Wednesday's levels.

A number of studies were triggered by the SPY pattern. The dominant themes examined large gaps lower that partially filled. At first blush it appeared as though a pattern such as this would've suggested bullish implications if the SPY closed below the 10ma. But since it closed above it the results appeared neutral or even slightly bearish. I took a closer look at some of those studies tonight and found that the neutral to bearish inclinations all appeared to take place during the 90s. More recent results have been positive. So let's look at a couple of these studies.

This 1st one was last seen in the 8/2/10 Subscriber Letter. I have shortened the length of the study and updated the results below.

SPY gaps down at least 1%. It closes down on the day but at least 0.5% above the open. Close > 10ma. Buy on close. Sell X days later. \$100k/trade. 9/1/98 - 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	10,132.06	8	5	3	62.50	4,124.36	-3,496.57	1.18	1.97	1,266.51
9	4,572.31	8	5	3	62.50	3,757.43	-4,738.29	0.79	1.32	571.54
8	14,372.87	9	6	3	66.67	4,214.62	-3,638.29	1.16	2.32	1,596.99
7	12,390.85	9	6	3	66.67	3,560.67	-2,991.05	1.19	2.38	1,376.76
6	14,515.17	9	6	3	66.67	3,606.20	-2,374.02	1.52	3.04	1,612.80
5	13,721.67	9	6	3	66.67	3,505.68	-2,437.46	1.44	2.88	1,524.63
4	9,117.68	9	7	2	77.78	2,560.81	-4,403.98	0.58	2.04	1,013.08
3	11,985.20	9	7	2	77.78	2,237.40	-1,838.29	1.22	4.26	1,331.69
2	11,284.45	9	8	1	88.89	1,572.52	-1,295.72	1.21	9.71	1,253.83
1	7,723.63	9	7	2	77.78	1,452.29	-1,221.19	1.19	4.16	858.18

All 9 instances closed above the entry price on either day 1 or day 2.

The number of instances is a bit low, but there appears to be a clear upside bias. This study only requires a close below yesterday's close. It doesn't require the gap never be filled during the day. But another study that was last seen in the 2/16/10 letter did require an unfilled gap. I have updated results for that one below.

SPY gaps down at least 1%. It never fills but closes at least 0.5% above the open. Close > 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	18,410.33	5	5	0	100.00	3,682.07	0.00	100.00	100.00	3,682.07
9	15,550.86	5	5	0	100.00	3,110.17	0.00	100.00	100.00	3,110.17
8	18,481.85	6	6	0	100.00	3,080.31	0.00	100.00	100.00	3,080.31
7	13,500.36	6	5	1	83.33	2,923.47	-1,117.00	2.62	13.09	2,250.06
6	13,376.61	6	5	1	83.33	2,695.43	-100.53	26.81	134.06	2,229.43
5	12,341.18	6	5	1	83.33	2,680.47	-1,061.15	2.53	12.63	2,056.86
4	8,311.08	6	5	1	83.33	1,877.22	-1,075.00	1.75	8.73	1,385.18
3	7,882.82	6	5	1	83.33	2,101.16	-2,623.00	0.80	4.01	1,313.80
2	5,400.45	6	4	2	66.67	1,816.48	-932.73	1.95	3.89	900.07
1	2,221.16	6	4	2	66.67	1,160.78	-1,210.97	0.96	1.92	370.19

Here again we see a very low number of instances but a clear upside tendency in those instances. Below is a list of all occurrences assuming an 8-day exit strategy.

SPY gaps down at least 1%. It never fills but closes at least 0.5% > the open. Close > 10ma. Buy on close. Sell X days later. \$100k/trade.1993 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
11/07/97	Buy	\$92.94	1.85%	\$2,547.75
11/19/97	Sell	\$94.66		(\$3,063.75)
11/12/01	Buy	\$112.03	3.26%	\$3,407.44
11/23/01	Sell	\$115.68		\$0.00
08/12/02	Buy	\$90.62	6.69%	\$7,202.59
08/22/02	Sell	\$96.68		(\$2,867.80)
10/22/02	Buy	\$89.52	0.84%	\$1,977.09
11/01/02	Sell	\$90.27		(\$2,814.84)
02/12/10	Buy	\$108.04	2.43%	\$3,274.50
02/25/10	Sell	\$110.67		\$0.00
02/25/10	Buy	\$110.67	3.42%	\$3,900.96
03/09/10	Sell	\$114.46		(\$505.68)

Not only are they all positive but rewards substantially outweigh risks when looking at run-up/drawdown stats.

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



The green Aggregator Line inched up a bit more and is now strongly 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 moved from negative to positive as the SPX closed lower. A close above 0 means the SPX has underperformed expectations over the last few days. So net expectations are positive and the SPX is relatively oversold versus recent expectations. Historically this combination has suggested an upside edge. The configuration can be seen on the chart whenever both lines close above 0. Due to this the Aggregator System turned long at the close.

The green Aggregator line is again set to close above 0 on Friday. This could change if bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,305.01. This is nearly 1.7% above Thursday's close. So it would take a very strong move higher on Friday to move the SPX into "overbought" territory. It seems the more likely scenario being suggested by the Aggregator is a multi-day rally.

With just 3 outstanding studies on the short-term active list I'm not overwhelmed with the bullish evidence. Still, there appears to be an upside edge and as a trader it is my job to make an effort to take advantage of that edge. Since evidence is a little weak and the intermediate-term outlook is neutral I'm going to take a conservative approach and scale in slowly to a position. I will look to put the 1st piece on Friday. 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>

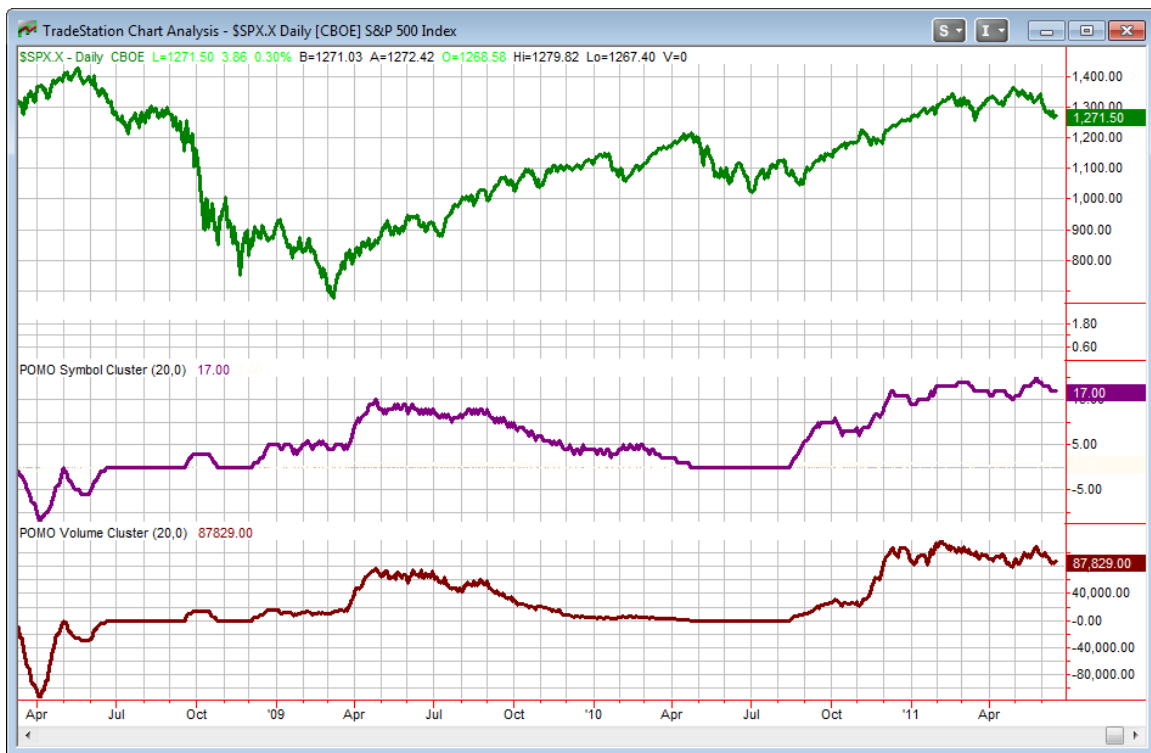
As bounces occur and FTDs are registered I will be sure to alert readers to odds and edges associated with FTDs.

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 \$600 billion 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 at \$128.30 LIMIT. Based on short-term outlook above. Using Thursday's close as my limit price I will look to begin building a long position.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
XIV	6/13/2011	\$170.38	\$165.42	-2.91%		

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