

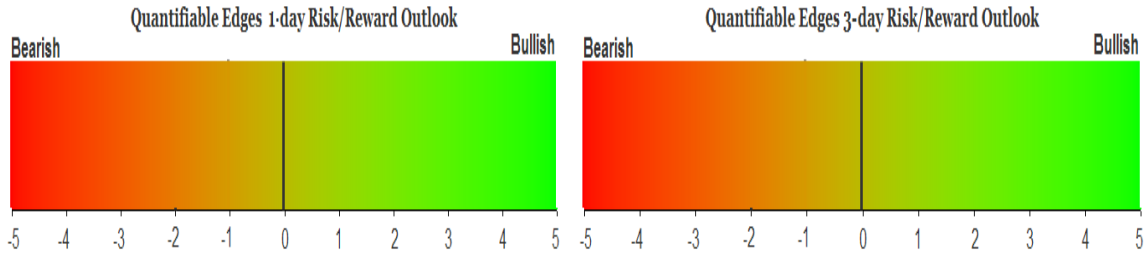
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 6, 2011

Volume 4 Issue 128

Market Overview



Signals Overview

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

Tonight's Research Points

- After 5 days higher the market pulled back today. When the market has been in a similar position in the past the 1-2 week timeframe has been strong.

Short-term Outlook

The Bottom Line

The Aggregator is neutral and I'm mostly sidelined awaiting better opportunities.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
July 5, 2011	3 days higher. Up vol % > 90% today.	1-7 days	Bullish	2.90%
July 5, 2011	5 days higher. >200 & < 50-high	1-10 days	Bullish	2.00%
July 5, 2011	VXO 15% < 10ma for 3rd day	1-2 days	Bearish	-1.90%
July 1, 2011	SPY closes month at high	1-6 days	Bullish	2.00%
Active - Long Term				
July 5, 2011	POMO over	int term	Bearish	
July 5, 2011	3 days higher. Up vol % > 90% today.	1-20 days	Bullish	5.00%
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%
October 25, 2010	SPX Golden Cross	int term	Bullish	
Dropped Tonight				
July 1, 2011	3 unfilled up-gaps	1-2 days	Bearish	

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

The Evidence

The market paused on Tuesday. After 5 days of solid gains, very little was accomplished. All indices traded in tight ranges. Results were mixed. The SPX closed down 0.1% while the Nasdaq rose 0.35% and the Russell 2000 gained 0.2%. Breadth was moderately negative as the NYSE Up Issues % came in at 48% and the Up Volume % was 39%. Total NYSE volume came in at the lowest level in about 2 weeks.

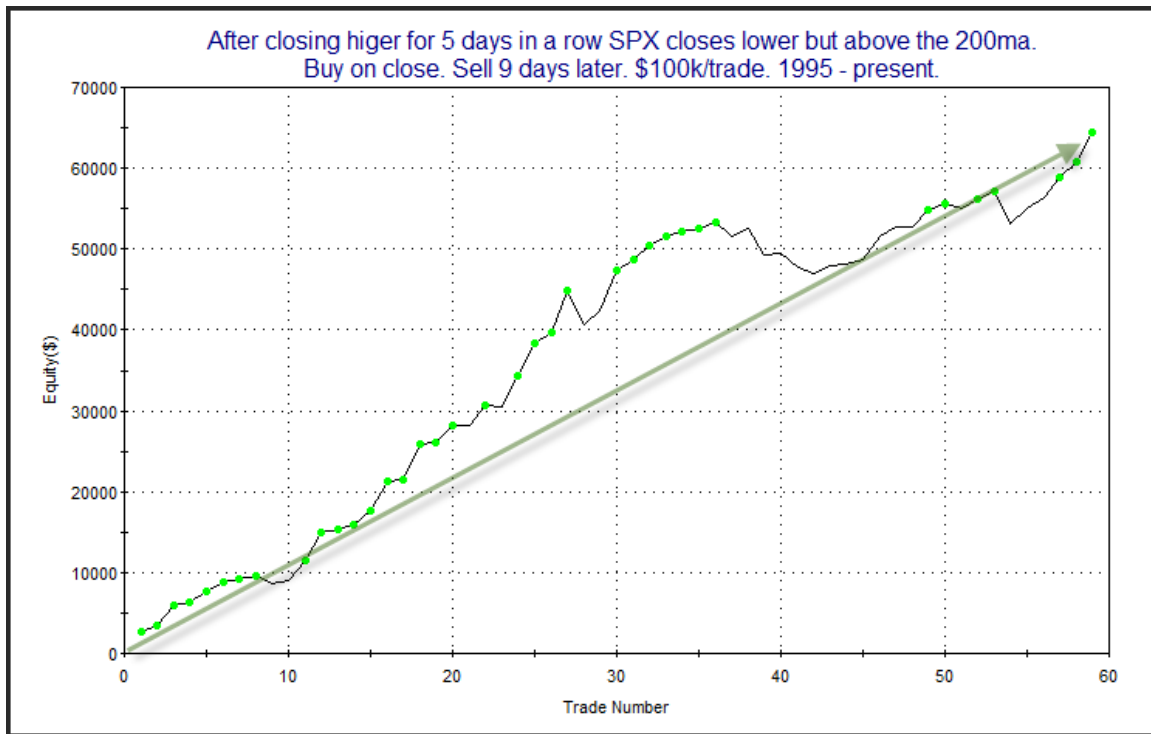
The Quantifinder identified a number of studies that related to Tuesday's inside day and narrow range. These studies generally all suggested no strong inclinations above the 200ma, but bearish inclinations if the SPX was trading below it. With the SPX now squarely above the 200ma, these studies don't need attention tonight.

Last night we looked at some studies that examined SPX performance after it had risen for 5 days in a row. Tuesday's moderately lower close triggered some studies that looked at pullbacks after at least 5 consecutive up days. The study below was last seen in the 1/31/11 Subscriber Letter. I have updated the results.

After closing higher for 5 days in a row SPX closes lower but above the 200ma. Buy on close. Sell X days later. \$100k/trade. 1995 - 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	64,078.77	54	44	10	81.48	1,766.47	-1,364.60	1.29	5.70	1,186.64
9	64,402.94	59	49	10	83.05	1,670.12	-1,743.29	0.96	4.69	1,091.58
8	56,290.05	60	42	18	70.00	1,904.72	-1,317.11	1.45	3.37	938.17
7	45,177.93	61	42	19	68.85	1,674.00	-1,322.63	1.27	2.80	740.62
6	44,306.67	64	44	20	68.75	1,574.82	-1,249.26	1.26	2.77	692.29
5	34,595.43	64	43	21	67.19	1,289.20	-992.39	1.30	2.66	540.55
4	31,817.38	64	41	23	64.06	1,252.76	-849.81	1.47	2.63	497.15
3	16,168.86	64	39	25	60.94	1,021.95	-947.49	1.08	1.68	252.64
2	10,532.42	64	39	25	60.94	865.72	-929.23	0.93	1.45	164.57
1	5,049.09	64	39	24	60.94	526.38	-644.98	0.82	1.33	78.89

56 of 64 instances (87.5%) closed above the entry price at some point in the next week.

Initially there appears to be a moderate inclination for a move higher. Once you get out 9-10 days the upside edge appears very substantial. Below is an equity curve using a 9-day exit strategy.



There's some wiggle here but the periods of pullback have been short and mild. This appears to confirm the bullish edge.

In that 1/31/11 letter I also showed results for times the market had closed at a 50-day high the day before. Below I instead filtered on times like the present where there wasn't a 50-day closing high.

After closing higher for 5 days in a row but not at a 50-day high SPX closes lower. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1995 - 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	22,898.54	13	11	2	84.62	2,381.04	-1,646.46	1.45	7.95	1,761.43
9	22,603.89	13	12	1	92.31	2,154.60	-3,251.34	0.66	7.95	1,738.76
8	20,977.94	13	11	2	84.62	2,287.72	-2,093.49	1.09	6.01	1,613.69
7	15,257.76	13	12	1	92.31	1,602.36	-3,970.62	0.40	4.84	1,173.67
6	13,564.19	13	11	2	84.62	1,748.45	-2,834.38	0.62	3.39	1,043.40
5	11,280.08	13	11	2	84.62	1,364.74	-1,866.01	0.73	4.02	867.70
4	9,245.64	13	10	3	76.92	1,212.13	-958.56	1.26	4.22	711.20
3	4,244.84	13	8	5	61.54	1,324.50	-1,270.24	1.04	1.67	326.53
2	-2,521.81	13	6	7	46.15	922.17	-1,150.69	0.80	0.69	-193.99
1	-1,735.19	13	8	5	61.54	388.68	-968.92	0.40	0.64	-133.48

The 1st couple of days are iffy, but after that the upside edge appears even stronger than without the filter applied. Of course the number of instances is a bit low, but the market position doesn't appear to raise any red flags.

These studies are very similar to the 5 Up Days study last night. Therefore, while they do act as nice confirmation of last night's bullish results, I feel they would just serve as duplication if incorporated into the Aggregator. So I have elected not to do so.

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



The green Aggregator line tonight moved up a bit and created some separation above 0. Readings above 0 mean net expectations from the active list are for upside over the next few days. Meanwhile, the Differential Line remains strongly below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are positive but the SPX is strongly overbought versus recent expectations. This is considered a neutral configuration. Neutral configurations are visible on the Aggregator chart whenever both lines close on opposite sides of 0. Due to this the Aggregator System remained flat at the close.

The green Aggregator line is again set to close above 0 on Wednesday. Of course that could change if compelling bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,320.37. This is about 1.3% below Tuesday's close. So it would take a large drop on Wednesday for the market to turn to oversold and be eligible for a long Aggregator entry.

It's a waiting game for me at this point. With the overbought market risk/reward appears worse than I would require to put capital to work. Therefore, I will wait mostly in cash until a more favorable opportunity appears. If this turns into a runaway bull market (which is possible) then you can expect pullbacks to be very brief and shallow for some time. This makes it difficult for dip-buyers to climb aboard since the market may not

truly get oversold for a while. Shallow pullbacks also force some traders to chase the market higher, which serves to increase upside momentum. If this occurs my general approach will keep me mostly sidelined (aside from systems like the Aggressive VIX). But if we do get a decent pullback over the next day or two then that could create a nice buying opportunity. Either way the next few days could give us some additional insights.

Intermediate-term Outlook (2 weeks – 2 months)– updated 7/5 – mildly bullish

The market put in a strong move this week, and that brought about quite a bit more bullish evidence.

First of all, I discussed in detail in last weekend's intermediate-term update that a strong move would need to occur over the 1st 2 days of the week in order for the SPX to close above its 6/21/11 Follow-Through Day (FTD) close on the 28th. The reason this was important is that the 1-week direction after a FTD has predicted the success or failure of that FTD with about 67% accuracy. Monday & Tuesday's performance was enough to put it in the plus column and predict a successful rally off the 6/21 FTD.

A second bit of evidence was offered in the short-term section above tonight. The study that looked at 3 consecutive days higher with the last day coming on 90% upside volume seemed to suggest bullish implications out over a month. I have added that study to the intermediate-term active list as well as the short-term list.

Another potential positive for the bulls this week was the Nasdaq's strong outperformance versus the SPX. Below is the SPX/Nasdaq Weekly Relative Strength chart from the charts page.

S&P 500/Nasdaq Relative Strength Weekly



I've circled the reading at the bottom of the chart. It is now appearing in green rather than red, indicating the line color is about to change because the Nasdaq has now taken over the lead from the SPX. This is important because since near the end of 1971 (which is the 1st possible new signal after the inception of the Nasdaq) the SPX generated over 100% of its positive performance when the Nasdaq has been leading. Over that time the SPX has gained 1,493.69 points when the Nasdaq has been in the lead. Since the SPX only sits at 1,339.67 today you can easily see how important a leading Nasdaq has been over the last 40 years. More details on this indicator can be found in the blog posts below.

<http://quantifiableedges.blogspot.com/2009/05/simple-powerful-timing-indicator.html>

<http://quantifiableedges.blogspot.com/2009/06/tweaking-nasdaq-leadlag-model.html>

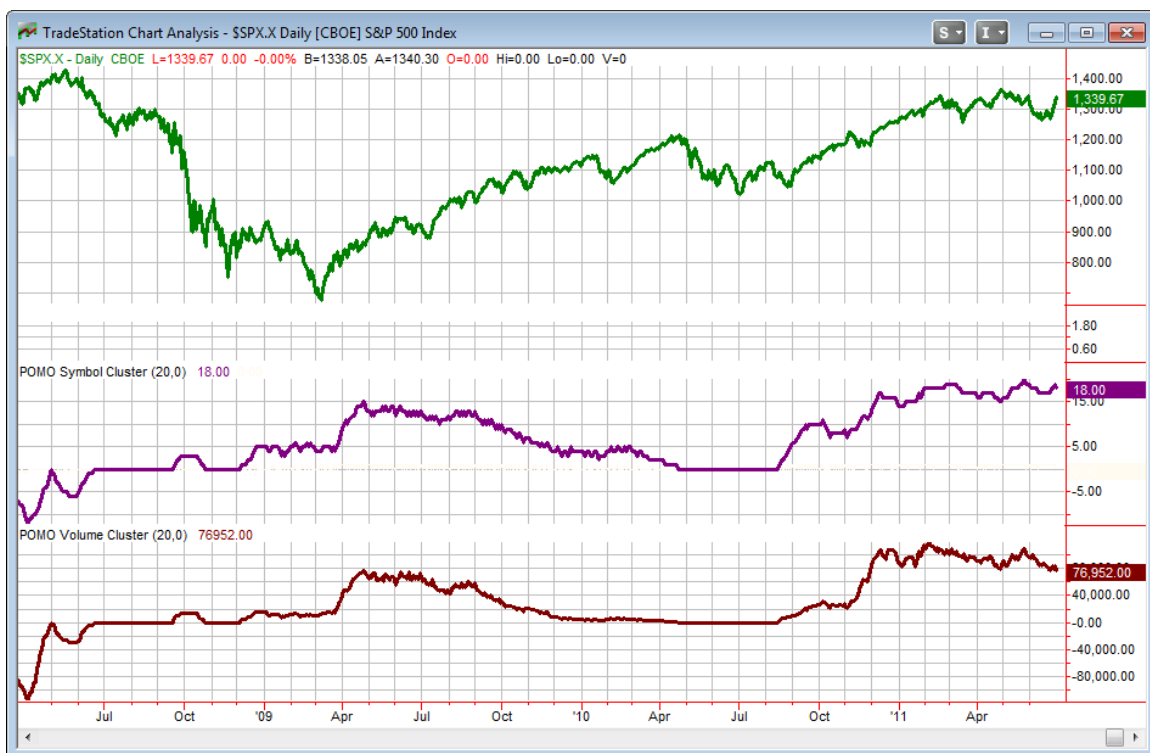
Additional for those subscribers that are interested in exploring this indicator more on their own, they may download the model in either Excel or Tradestation format from the downloads page of the members site at any time.

<http://www.quantifiableedges.com/members/memdownloads.php>

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>



QE2 ended on Thursday. The POMO volume indicator reading has already begun to drop as buying levels were reduced during June. Starting this week we are going to see the level of activity plummet.

The absence of POMO buying is my biggest intermediate-term concern at the moment. Over the last six years POMO activity has seemed to have a larger influence on market performance than anything else I can point to. POMO buying has consistently occurred in conjunction with market rallies. Meanwhile times without buying, and especially those times where there was net selling, the market has struggled mightily and been prone to severe corrections.

Previous instances where the fed has ended POMO buying there has not been a negative market impact that was perceptible for about one month. There's no telling if we will be allowed such an extensive grace period this time.

I should note that there is scheduled to be a minor amount of buying associated with principal payments expected to be received from prior purchases. So POMO activity may not completely come to a halt, but it will be so dramatically reduced that we are now going to see a dripping liquidity pump rather than a gushing one. As such, I have changed the POMO indicator in the studies list from bullish to bearish.

So at this point the market has provided us with bullish intermediate-term evidence in the form of a high probability Follow-Through Day, a leading Nasdaq, and bullish breadth and priced-based studies. There are some minor negatives, such as the divergence in the number of 52-week highs over the last year+, but the big negative is the end of QE2. In my eyes this is a big enough negative to warrant caution, even with all the other positives. So my outlook is now mildly bullish. I will therefore use some extra caution with my long trades, and be especially vigilant with short trades.

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.

No new trade ideas tonight.

Current Open Trade Ideas

None

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