

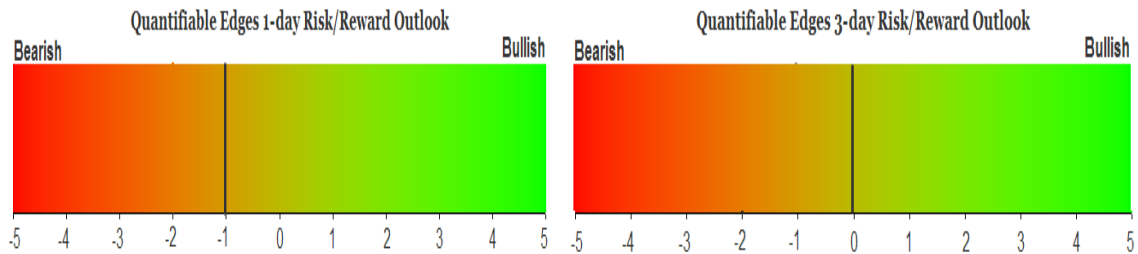
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 8, 2011

Volume 4 Issue 130

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- Consistent closes in the upper part of the day's range are another sign the SPY is overbought and likely to pull back.

## Short-term Outlook

### The Bottom Line

The Aggregator is neutral and I'm mostly sidelined. The SPX is again too extended to consider buying so I'll be waiting another day.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
July 8, 2011	8-day Avg. SPY closing range > 75%	1-2 days	Bearish	-1.40%
July 7, 2011	SPY 10-high on 20-day volume low	1-2 days	Bearish	-1.10%
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%
<b>Active - Long Term</b>				
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	
<b>Dropped Tonight</b>				
July 1, 2011	SPY closes month at high	1-6 days	Bullish	2.00%

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

## *The Evidence*

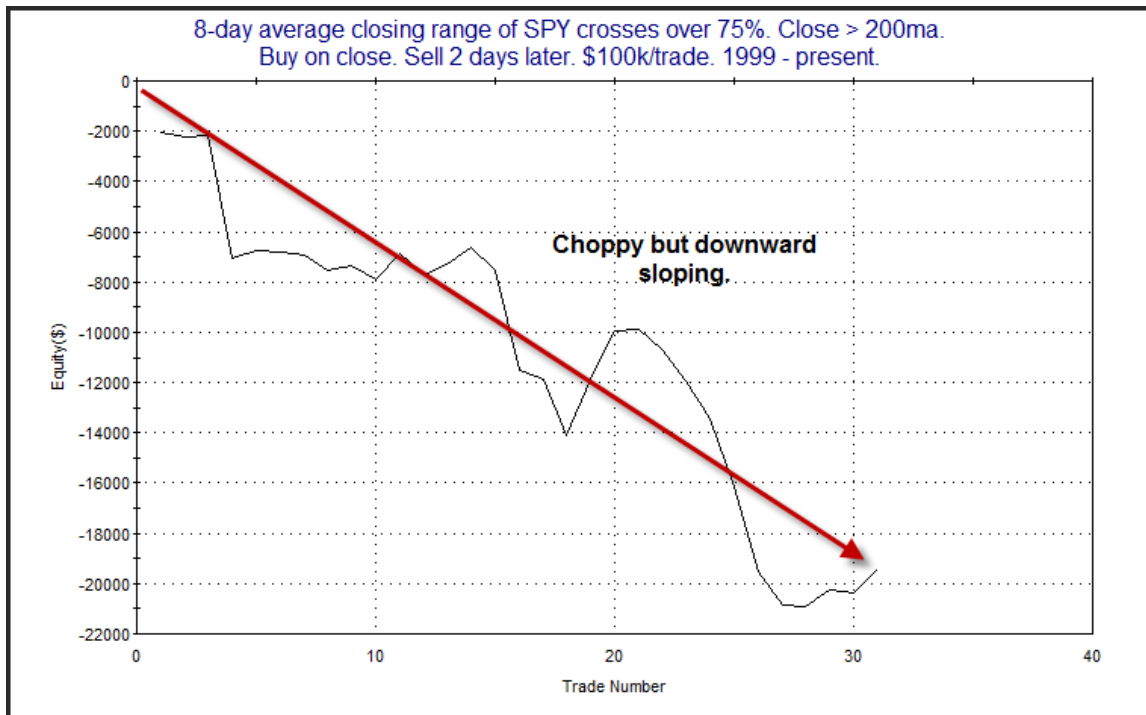
Jobs news help to spark early excitement and the market held firm post-open and then added further to the gains. In the end the SPX rose 1.0%, the Nasdaq was up 1.4% and the Russell 2000 gained 1.5%. Breadth was very strong with the NYSE Up Issues % coming in at 77% and the Up Volume % at 82%. The rally also came on increasing volume.

In an odd way both my expectations and fears were realized on Thursday. I'd been talking the last few nights about the possibility of a runaway up-move. The current market had signs of it including 1) it was coming off a low, 2) there was exceptional momentum seen last week which could be measured using price or breadth, and 3) the pullback earlier this week was brief and shallow. Now it has powered higher again. While it's nice to be right, my fears were realized in that the market did not provide a favorable entry point. It needed to pull back a bit deeper or at least consolidate for another day to allow me to get on board the move with most of my methods. The only system providing exposure Thursday was the relatively new Aggressive VIX system. Hopefully some subscribers were more aggressive with their entries than me and were able to profit from Thursday's rally.

There wasn't an overwhelming amount of new evidence tonight. One study the Quantifinder did identify was last seen in the 4/27/11 subscriber letter. It looks at the closing range of the SPY. When it has managed to consistently close in the upper part of its range, that is one sign that the market is overbought and ripe for a short-term pullback. The study is below. I have updated all stats.

8-day average closing range of SPY crosses over 75%. Close > 200ma. 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	-21,456.70	27	13	14	48.15	905.39	-2,373.34	0.38	0.35	-794.69
4	-17,747.36	27	12	15	44.44	976.04	-1,963.99	0.50	0.40	-657.31
3	-16,214.39	28	11	17	39.29	895.93	-1,533.51	0.58	0.38	-579.09
2	-19,378.78	31	11	20	35.48	758.41	-1,386.06	0.55	0.30	-625.12
1	-9,227.96	31	14	17	45.16	302.83	-792.21	0.38	0.31	-297.68

While the downside edge appears to remain in place for a full week, most of the edge has been realized over the 1<sup>st</sup> 2 days. Below is an equity curve showing how the edge has played out using a 2-day exit strategy.



It hasn't been the most consistent edge but I think it still appears worthy of consideration.

There were also some studies that triggered Thursday that examined unfilled up gaps that finished strong and at new highs. With the market trading well above the 200ma there doesn't appear to be a substantial edge provided by Thursday's SPY pattern. I looked at similar setups in the 4/4/11 letter. Rather than spend a lot of time on a neutral study I've simply provided a link below to that letter. The current setup is the same as the 1<sup>st</sup> study shown in the letter.

[2011-04-04 QE Subscriber Letter.pdf](#)

So the stretched conditions have left us with a bit more bearish evidence tonight. Still, it isn't enough to turn expectations entirely.

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



Tonight's study nearly took the green Aggregator line down to 0, but it still managed a positive reading. Readings above 0 mean net expectations from the active list are for upside over the next few days. Meanwhile, the Differential Line remains well 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 still 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 Thursday. Of course that could change if compelling bearish evidence emerges. It could also change if we rally strongly and the current bullish studies reach their targets and are removed from the Active List. Meanwhile, the Differential Pivot will be 1,340.54. This is about 0.9% below Thursday's close. In other words, the SPX would need to drop at least this much in order for the Differential Line to flip back to positive on Friday.

It's too bad the market made its move up without allowing me to climb aboard, but it's a risk I was aware of and had considered. I generally don't chase when the market is overbought. In instances like today that has cost me, but over the long run avoiding buying into overbought markets reduces portfolio volatility and has had very little impact on returns. I'd rather sit it out and just risk capital on opportunities I believe have very positive reward/risk ratios. Every methodology has its drawbacks and being sidelined when the market is screaming higher without pause is a drawback to my approach.

As I'm sure you've ascertained, I'm not about to start chasing long trades now. For me it is a test of patience at this point while I await the next favorable opportunity.

***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 1<sup>st</sup> 2 days of the week in order for the SPX to close above its 6/21/11 Follow-Through Day (FTD) close on the 28<sup>th</sup>. 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 1<sup>st</sup> 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>

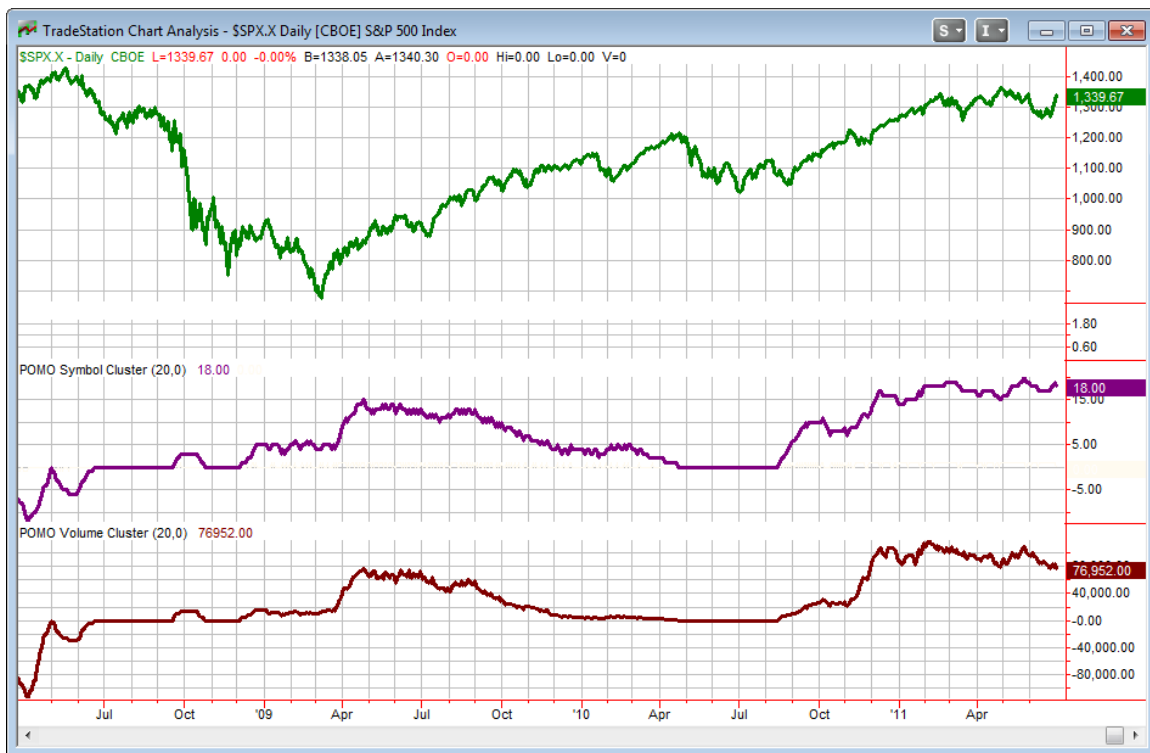
Additional for those subscribers that are interested in exploring this indicator more on their own, they may download the model in either Excel or Tradestation format from the downloads page of the members site at any time.

<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 3<sup>rd</sup> 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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