

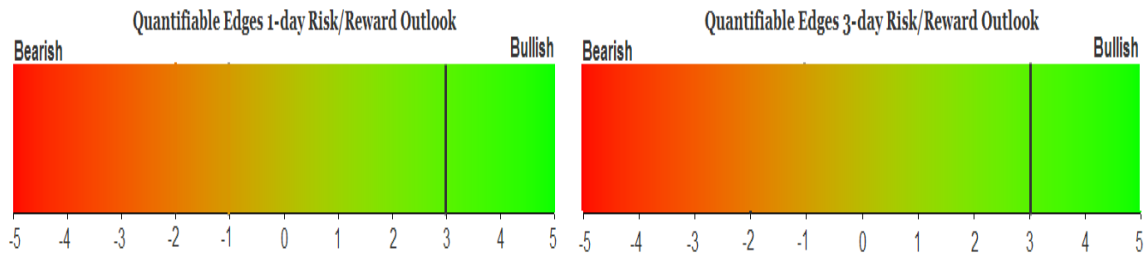
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 12, 2011

Volume 4 Issue 132

Market Overview



Signals Overview

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

Tonight's Research Points

- 5% Up Volume days are extreme and suggest a short-term bounce.
- 2 unfilled down gaps above the 200ma are commonly followed by a short-term upmove.
- Turnaround Tuesday hasn't held up under similar circumstances in the past.
- A gap down Tuesday morning could create a favorable short-term buying opportunity.

Short-term Outlook

The Bottom Line

The studies are suggesting a bounce and the market is now oversold after the last 2 days. I'm looking to start scaling 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				
July 12, 2011	SPY dn 2 days. 5 low. Monday > 200ma.	1 day	Bearish	
July 12, 2011	SPY 2 unfilled dn gaps. 5-low & >200ma	1-5 days	Bullish	1.70%
July 12, 2011	Up Vol < 5%. SPX > 10-low / 200ma	1-2 days	Bullish	2.80%
July 11, 2011	Island Top	1-8 days	Bearish	-2.40%
July 11, 2011	Worst breadth & volume in 3 weeks	1-4 days	Bullish	1.90%
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%
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 11, 2011	Unfilled Friday Gap	1 day	Bullish	

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

The Evidence

The bears dominated on Monday from before the market opened all the way until the close. All the major indices sold off. The SPX closed down 1.8%, the Nasdaq sold off 2.0%, and the Russell 2000 lost 2.2%. Breadth came in extremely negative as the NYSE Up Issues % was 14.5% and the Up Volume % was just 3%. Total NYSE volume rose from Friday's level but not to any kind of extreme.

The strong selling and tremendously negative breadth on Monday triggered a good number of studies in the Quantifinder. I'll highlight those that I found most notable below.

Up volume % readings that come in less than 5% have typically signaled short-term exhaustion and have commonly been followed by at least a brief bounce. The study below was last seen in the 6/2/11 Subscriber Letter. It looks at 5% days when the SPX is trading above its 200ma. Results are all updated.

NYSE Up Vol % < 5%. SPX > 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1988 - 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	14,472.49	9	6	3	66.67	4,114.69	-3,405.22	1.21	2.42	1,608.05
9	20,969.46	9	7	2	77.78	3,449.99	-1,590.24	2.17	7.59	2,329.94
8	19,140.40	9	7	2	77.78	3,290.56	-1,946.76	1.69	5.92	2,126.71
7	20,151.92	9	8	1	88.89	2,932.90	-3,311.32	0.89	7.09	2,239.10
6	14,254.93	10	7	3	70.00	3,166.35	-2,636.50	1.20	2.80	1,425.49
5	16,290.73	10	7	3	70.00	3,348.27	-2,382.40	1.41	3.28	1,629.07
4	9,148.59	10	7	3	70.00	2,687.90	-3,222.23	0.83	1.95	914.86
3	9,643.36	10	7	3	70.00	2,066.51	-1,607.40	1.29	3.00	964.34
2	10,247.39	10	7	3	70.00	1,892.75	-1,000.62	1.89	4.41	1,024.74
1	6,771.56	10	6	4	60.00	1,532.13	-605.30	2.53	3.80	677.16

Instances are low but the results appear quite compelling anyway. The only instance not to close above its entry price on either day 1 or day 2 was the last one which occurred on 6/1/11.

Another study that was similar to this one last appeared in the 5/17/10 letter. It ignored the 200ma but looked at all 5% breadth occurrences where the SPX failed to close at a 10-day low. Results here are updated as well.

NYSE Up Vol % < 5%. SPX closes > lowest close of last 10 days. Buy SPX on close. Sell X days later. \$100k/trade. 1988 - 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	20,915.29	12	8	4	66.67	4,035.80	-2,842.77	1.42	2.84	1,742.94
4	16,222.43	12	8	4	66.67	4,199.86	-4,344.11	0.97	1.93	1,351.87
3	23,865.66	12	8	4	66.67	3,384.79	-803.17	4.21	8.43	1,988.80
2	21,150.40	12	10	2	83.33	2,267.10	-760.32	2.98	14.91	1,762.53
1	18,233.84	12	11	1	91.67	1,687.53	-329.00	5.13	56.42	1,519.49
All 12 instances closed above the entry price at some point in the next 2 days.										

Similar to the last study there aren't a great number of instances. Still, the chance of a quick bounce appears high. In this case it appears to only be a short-lived 1-2 day edge. Interestingly, there were only 3 instances where both studies triggered. In the 5/17/10 letter I looked at results if at least one of the price requirements was met. This provided a larger sample size. I also reran that test below.

NYSE Up Vol % < 5%. SPX is either > 200ma or > 10-day low. Buy SPX on close. Sell X days later. \$100k/trade. 1988 - 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	36,578.46	19	13	6	68.42	3,913.35	-2,382.53	1.64	3.56	1,925.18
4	27,509.72	19	13	6	68.42	3,762.53	-3,567.20	1.05	2.29	1,447.88
3	31,874.12	19	13	6	68.42	2,930.27	-1,036.57	2.83	6.12	1,677.59
2	30,607.47	19	15	4	78.95	2,254.70	-803.26	2.81	10.53	1,610.92
1	24,847.69	19	15	4	78.95	1,817.93	-605.30	3.00	11.26	1,307.77

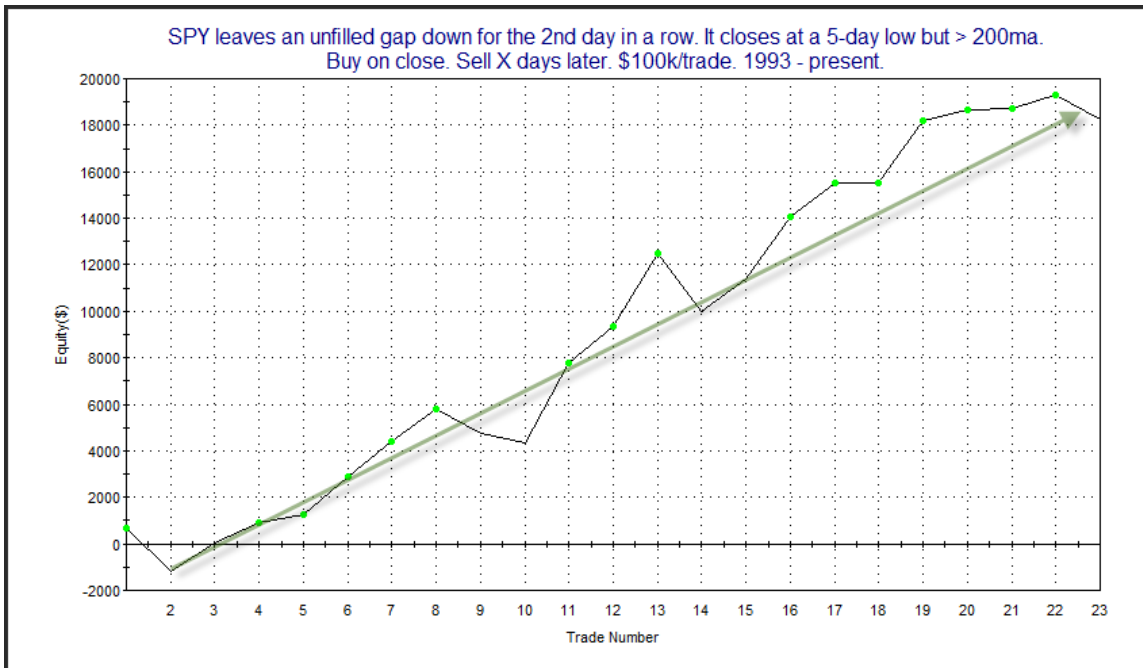
Bottom line here is that the extremely negative breadth seems to often exhaust the sellers (at least temporarily). This sets up a high probability of a 1-2 day bounce.

Two consecutive unfilled down gaps during a long-term uptrend are fairly unusual. The study below was last seen in the 6/7/11 letter and it examined this. This study is also updated.

SPY leaves an unfilled gap down for the 2nd day in a row. It closes at a 5-day low 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	18,262.15	23	18	5	78.26	1,393.53	-1,364.27	1.02	3.68	794.01
4	15,451.96	23	17	6	73.91	1,306.74	-1,127.11	1.16	3.28	671.82
3	12,674.18	23	16	7	69.57	1,107.58	-721.00	1.54	3.51	551.05
2	5,782.47	23	15	8	65.22	951.57	-1,061.38	0.90	1.68	251.41
1	1,218.86	24	14	10	58.33	692.11	-847.07	0.82	1.14	50.79

Only 1 instance failed to close above the entry price at some point in the next 5 days. That instance occurred on 9/14/99.

While the size of the average trade isn't as powerful as the earlier studies, the reliability of the setup has been quite good. Below is an equity curve that assumes a 5-day exit strategy.



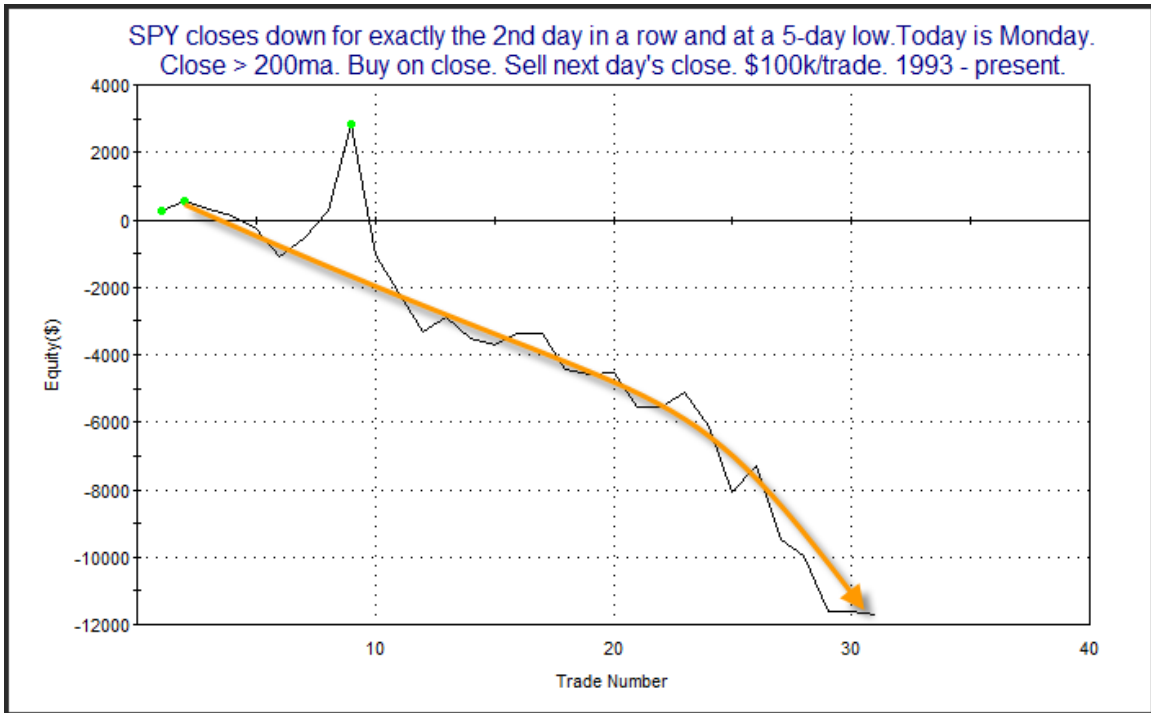
The strong, steady equity curve serves as confirmation of the upside edge.

Tuesdays are renowned for being “turnaround” days where sharp moves often get reversed. The current setup seems to be the rare kind that does not suggest a “Turnaround Tuesday” edge. I have updated the study below from the 5/24/11 letter.

SPY closes down for exactly the 2nd day in a row and at a 5-day low. Today is Monday.
Close > 200ma. Buy on close. Sell next day's close. \$100k/trade. 1993 - present.

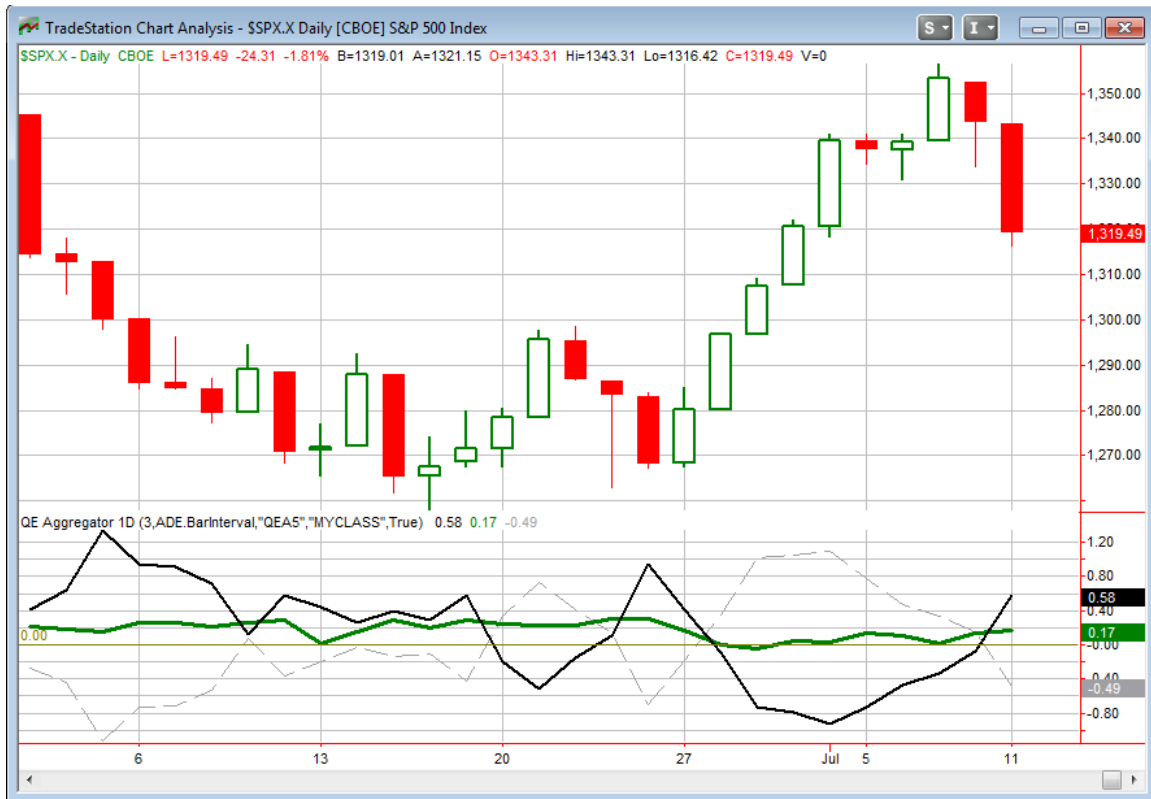
TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	(\$11,696.90)	Profit Factor	0.36
Gross Profit	\$6,570.43	Gross Loss	(\$18,267.33)
Total Number of Trades	31	Percent Profitable	32.26%
Winning Trades	10	Losing Trades	21
Even Trades	0		
Avg. Trade Net Profit	(\$377.32)	Ratio Avg. Win:Avg. Loss	0.76
Avg. Winning Trade	\$657.04	Avg. Losing Trade	(\$869.87)
Largest Winning Trade	\$2,539.68	Largest Losing Trade	(\$3,870.38)

The stats all seem to favor the bears. Below is an equity curve which supports the bearish case.



Frankly I find this Turnaround Tuesday study to be the least compelling of those shown tonight because it fails to account for the extremeness of the decline. The others use breadth and gaps to take the strength of the move under consideration. I did include all 3 concepts on the Active List.

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



The strongly bullish tilt to tonight's studies caused the green Aggregator line to rise a little further above 0. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the strong selling caused the Differential Line to spike strongly above 0. A positive Differential reading means the SPX has underperformed expectations over the last few days. So net expectations are positive and the SPX is oversold versus recent expectations. Historically this combination has offered an upside edge. It can be seen on the Aggregator chart when both lines are above 0. Due to this the Aggregator System changed from flat to long at the close.

The green Aggregator line is again set to close above 0 on Tuesday. This is unlikely to change. Meanwhile, the Differential Pivot will be 1,355.91. This is over 2.75% above Monday's close. An up day of this magnitude is huge longshot. A more likely scenario is that the edge plays out with a multi-day bounce.

This pullback looks buyable to me, though it isn't yet clear what is likely to happen beyond an initial bounce. Perhaps the island formation I discussed last night will mark a short or intermediate-term top. Or perhaps the studies from the July 5th letter that were looking for the momentum to continue higher will prevail. Often the bounce will provide us clues. For now, I'm going to look to take on long exposure. Since the edge appears

short-term I may take up to 2 lots tomorrow. Without an aggressive plan I might not get a chance to take on additional exposure. Details in the trade ideas section lower down.

Note on overnight futures drop

The S&P futures are taking a hit late at night. They are down between 9-10 points at the moment. It would be unusual to see SPY gap down big tomorrow after already posting 2 unfilled down gaps on Friday and Monday. I took a peak at the setup below tonight. Depending on how things look when I wake up I may look at it different ways as well. If I do, I will likely post additional results to the blog (and send out a tweet when/if I do).

After posting 2 unfilled down gaps SPY gaps down at least 0.5% on day 3. Buy on open. Sell on close.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
12/11/97	Buy	\$96.31	(0.78%)	\$287.84
12/11/97	Sell	\$95.56		(\$1,028.00)
01/13/99	Buy	\$120.41	2.47%	\$3,794.88
01/13/99	Sell	\$123.38		(\$24.12)
10/22/07	Buy	\$148.84	1.14%	\$1,282.56
10/22/07	Sell	\$150.54		(\$120.24)
03/03/08	Buy	\$133.14	0.27%	\$500.49
03/03/08	Sell	\$133.50		(\$672.30)
03/04/08	Buy	\$132.23	0.57%	\$876.33
03/04/08	Sell	\$132.99		(\$928.76)
08/12/10	Buy	\$107.65	0.91%	\$1,252.18
08/12/10	Sell	\$108.63		(\$45.70)

2 days later every instance closed above its entry price.

There are too few instances to get very excited, but it does seem to hint that a large gap down could be a decent short-term buying opportunity.

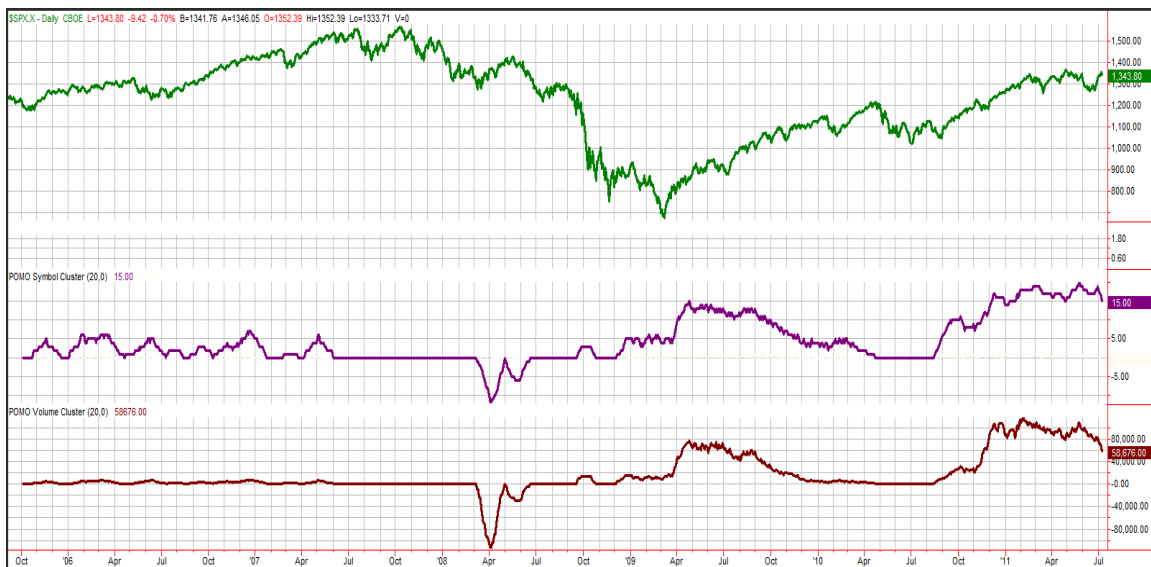
Intermediate-term Outlook (2 weeks – 2 months)– updated 7/11 – mildly bullish

Even with Friday’s move lower the major indices managed to post gains for the week and are all nearing their spring highs. Not a lot changed from last week on the intermediate-term front. With QE2 now over the most significant change to the intermediate-term indicators may be the rapid decline that has begun with the POMO indicators.

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>



There was just one day of buying this past week. There is also currently one day scheduled for this upcoming week. POMO activity is currently limited to buying associated with principal payments expected to be received from prior purchases. Compared to what the market had become accustomed to, this is likely to me a miniscule number that will serve to provide little to no stimulus. The next operations schedule is set to be released on Wednesday at 2pm, so we will see just how much of this buying is likely to take place over the next month. When available the schedule will be posted to the Fed’s website and you may view it using the link below:

http://www.newyorkfed.org/markets/tot_operation_schedule.html

The POMO chart is a little harder to read this week because I elected to show the long-term view rather than the typical shorter-term one. I did this so you might better see the struggles the market has endured during those periods when POMO activity was flat or

negative. I last posted a chart like this on the blog about a month and a half ago. If you'd like to view that chart you may use the link below. On it I showed periods with net Fed buying in green, inactivity in white, and net selling in red.

<http://2.bp.blogspot.com/-jPZivVMTH-4/TdbKqBMMEHI/AAAAAAAAAByg/EKR4MFO4nBg/s1600/2011-05-20.png>

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 the market has struggled mightily and been prone to severe corrections. The market has been in bull-market mode for the better part of 2 years now. But in looking at the POMO chart you can see that it hasn't managed to rally without stimulus since 2005 when the Fed data begins. Can the market extend this already long bull run with minimal or no stimulus? I have my doubts. Other instances did provide about a 1-month "grace period" before the market began to suffer, so perhaps we'll get through July before the market begins to feel the effects.

There are still a number of intermediate-term market positives that can be pointed to. Several of these I went over in some detail last week. The Intermediate-Term Active list at the top of the letter shows there is still a high-probability Follow-Through Day signal active, the Nasdaq is leading the SPX, breadth has issued bullish intermediate-term signals, and price action has as well. The combination of evidence is enough to keep me favoring the bull side for the time being. POMO is a large concern though, and it could be a ticking time-bomb that goes off later this summer if not sooner.

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 @ \$131.97 limit.** Based on Aggregator and short-term outlook above. I'm looking to enter the 1st part of my position at a limit price equal to Monday's close.*

***SPY – If filled on first lot, buy ¼ index position ON CLOSE at a limit price \$0.50 below the entry price for the 1st lot.** If the selling continues throughout the day I'll look to scale in and increase my position.*

Current Open Trade Ideas

None

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