

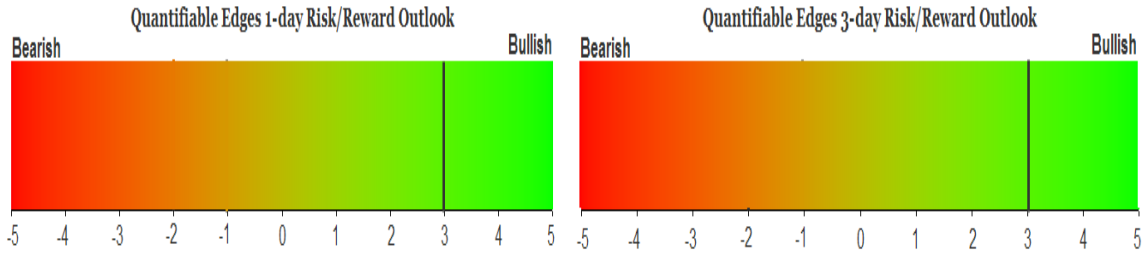
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 13, 2011

Volume 4 Issue 133

Market Overview



Signals Overview

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

Tonight's Research Points

- 3-day pullbacks suggest an upside edge when they occur following a 20-day high and the most recent day contains the mildest selling.
- A drop between 0.25%-0.75% following a 1-day loss of 1.75% has typically been followed by a substantial bounce when the market is above its 200ma.

Short-term Outlook

The Bottom Line

The market is short-term oversold and the studies are suggesting a bounce is probable. Though I have some hesitations, I am long and looking to get longer.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
July 13, 2011	Pullback slowing	1-5 days	Bullish	2.50%
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 12, 2011	SPY dn 2 days. 5 low. Monday > 200ma	1 day	Bearish	

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

The Evidence

After a lot of wiggling sellers came in to the market again in the late afternoon and drove the major indices lower. The SPX closed down 0.4%, the Nasdaq fell 0.7% and the Russell 2000 lost 0.5%. Breadth numbers were expectedly negative. The NYSE Up Issues % came in at 42% and the Up Volume % was 32%. Total NYSE volume rose to the highest level so far in July.

The theme of the studies that appeared in the Quantifinder tonight centered around the fact that the selloff was slowing. This appears to be a good thing. Let's look at it a few different ways.

Tuesday marked the third down day in a row. Three day pullbacks will often suggest an upside edge, but you need more than just three down days on their own. It's important to look for certain characteristics in the pullback that suggests the upside edge will be substantial. I mentioned above that the fact the pullback is slowing is a positive. Another positive is that the market is coming off of an intermediate-term high. The two studies below are from the 1/11/11 subscriber letter. In that I compared slowing 3+ day pullbacks that were coming off a 20-day high versus those that weren't. First let's examine results when the pullback is **not** occurring immediately after a 20-day high. (Results for both tests are updated.)

SPX has at least 3 lowers closes. Today is the mildest drop of the decline. Just prior to the pullback the market did NOT close at a 20-day high. Close > 200ma.
Buy on close. Sell X days later. \$100k/trade. 1989 - 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	32,048.34	65	44	21	67.69	2,485.13	-3,680.83	0.68	1.41	493.05
9	54,068.14	67	44	23	65.67	2,693.41	-2,801.82	0.96	1.84	806.99
8	46,448.29	67	43	24	64.18	2,531.05	-2,599.46	0.97	1.74	693.26
7	55,972.18	69	44	25	63.77	2,416.26	-2,013.73	1.20	2.11	811.19
6	38,258.71	69	42	27	60.87	2,088.76	-1,832.19	1.14	1.77	554.47
5	40,316.46	70	38	32	54.29	2,126.49	-1,265.32	1.68	2.00	575.95
4	30,895.14	72	45	27	62.50	1,698.47	-1,686.52	1.01	1.68	429.10
3	9,594.52	72	42	30	58.33	1,329.77	-1,541.87	0.86	1.21	133.26
2	16,357.43	76	43	33	56.58	1,188.27	-1,052.67	1.13	1.47	215.23
1	15,116.28	79	43	35	54.43	1,050.04	-858.16	1.22	1.50	191.35

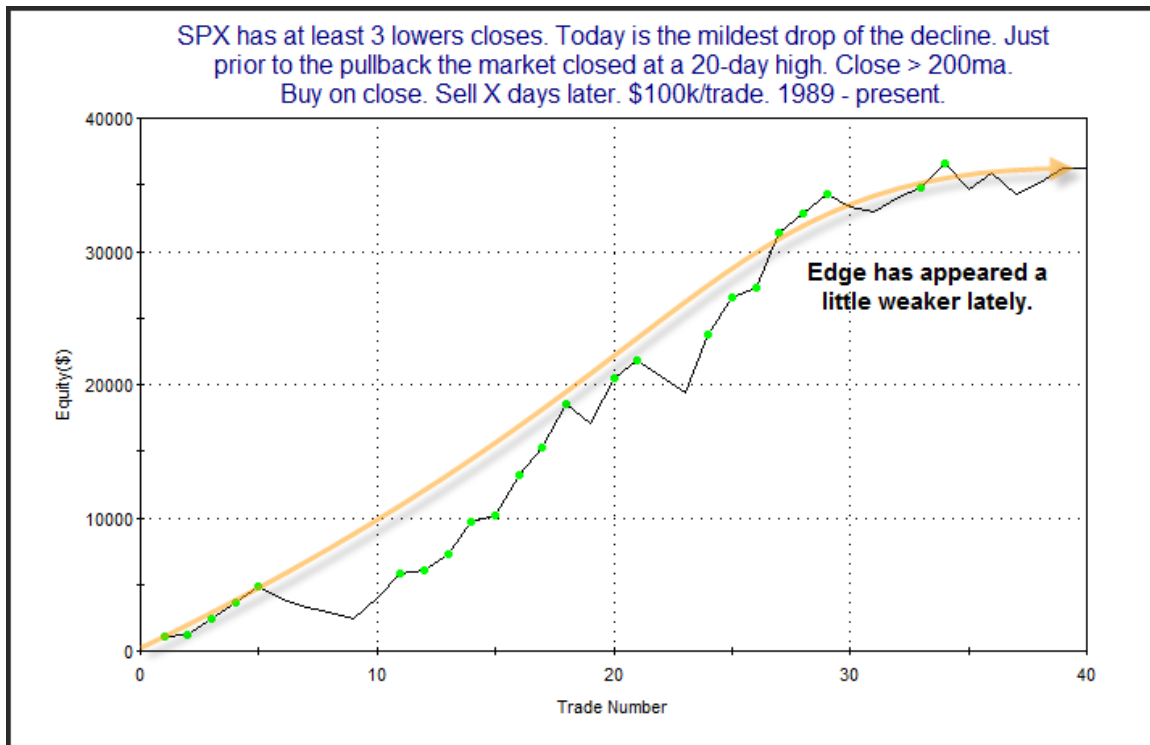
Results here suggest a very mild bullish inclination. Now let's look at the same setup, but this time it is following a 20-day high like we have now.

SPX has at least 3 lowers closes. Today is the mildest drop of the decline. Just prior to the pullback the market closed at a 20-day high. Close > 200ma.
Buy on close. Sell X days later. \$100k/trade. 1989 - 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	50,318.55	39	27	12	69.23	2,534.77	-1,510.02	1.68	3.78	1,290.22
9	49,501.14	39	28	11	71.79	2,437.10	-1,703.43	1.43	3.64	1,269.26
8	39,933.86	39	28	11	71.79	2,201.20	-1,972.71	1.12	2.84	1,023.95
7	34,683.13	40	26	14	65.00	2,218.52	-1,642.75	1.35	2.51	867.08
6	38,632.14	40	26	14	65.00	2,081.00	-1,105.28	1.88	3.50	965.80
5	35,522.19	40	28	12	70.00	1,952.20	-1,594.95	1.22	2.86	888.05
4	37,607.47	40	25	15	62.50	2,122.56	-1,030.44	2.06	3.43	940.19
3	36,212.51	40	29	11	72.50	1,633.87	-1,015.42	1.61	4.24	905.31
2	27,597.35	41	29	12	70.73	1,292.06	-822.70	1.57	3.80	673.11
1	13,926.16	46	31	14	67.39	749.58	-665.06	1.13	2.50	302.74

90% of instances closed above the entry price at some point in the next 5 days.

There appears to be a substantial difference. These results are much more appealing. To see how the edge has played out over time I have included an equity curve below that assumes a 3-day holding period.



The strength of the edge appears to be waning over more recent instances, but at this point I still believe the study is worth consideration.

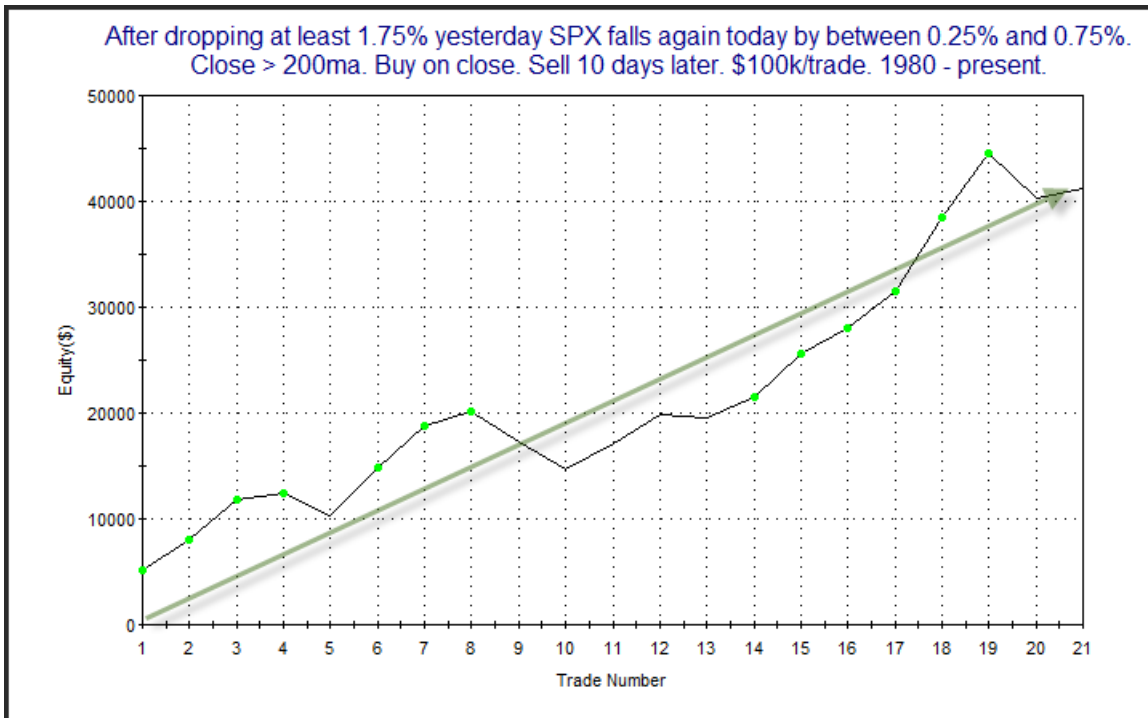
Another set of studies that considered the slowing pullback looked at market action on the day following a drop of at least 1.75%. There were a few studies that appeared along these lines. Perhaps the most compelling look at market performance following a drop of less than 0.5%. Tuesday's drop was 0.44%. It qualified for this study, but just barely. I therefore felt the study below provided a sample set more representative of current conditions. The study was last shown in the 2/24/11 subscriber letter. All results have been updated.

After dropping at least 1.75% yesterday SPX falls again today by between 0.25% and 0.75%.
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
10	41,243.62	21	16	5	76.19	3,335.34	-2,424.35	1.38	4.40	1,963.98
9	38,044.69	21	16	5	76.19	3,158.64	-2,498.71	1.26	4.05	1,811.65
8	38,015.12	21	15	6	71.43	3,116.99	-1,456.63	2.14	5.35	1,810.24
7	28,651.44	21	15	6	71.43	2,549.19	-1,597.74	1.60	3.99	1,364.35
6	24,725.01	21	16	5	76.19	2,115.02	-1,823.07	1.16	3.71	1,177.38
5	20,713.68	21	16	5	76.19	1,816.71	-1,670.74	1.09	3.48	986.37
4	12,981.81	21	13	8	61.90	1,874.04	-1,422.59	1.32	2.14	618.18
3	9,384.40	21	12	9	57.14	1,829.81	-1,397.04	1.31	1.75	446.88
2	947.55	22	14	8	63.64	1,188.84	-1,962.02	0.61	1.06	43.07
1	-4,828.23	22	13	9	59.09	819.48	-1,720.16	0.48	0.69	-219.46

90% of instances closed above the entry price at some point in the next 5 days. 95% did so within 6 days.

Day one looks a little sketchy, but days 2-9 all suggest strong, steady buying. Stats across the board are solid, including win percentage, win/loss ratio, profit factor, and average trade. The equity curve below shows how the edge has played out over time.



The relatively steady upslope acts as a nice confirmation of the short-term bullish edge.

So we see from a few different angles tonight that this slowing, 3-day pullback in a longer-term uptrend appears to be reaching a point where a bounce is likely. Since both studies were somewhat similar and solely utilized price action I have combined them for purposes of generating estimates in the Aggregator.

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



Once again tonight the green Aggregator line is squarely above 0. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the 3-day selloff has caused the Differential Line to rise 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 whenever both lines are above 0. Due to this the Aggregator System remained long at the close.

The green Aggregator line is again set to close above 0 on Wednesday. This is unlikely to change. Meanwhile, the Differential Pivot will be 1,346.51. This is over 2.5% above

Monday's close. An up day of this magnitude is quite a longshot. A more likely scenario is that the edge plays out with a multi-day bounce.

The 5% breadth studies from last night are also still active. They suggested a high probability of a move higher at some point over the following two days. We didn't get it on day one. Aside from the news flow, I'm not seeing any technical reason that it shouldn't arrive on day two.

I'm a bit torn with regards to how aggressive to get right now with my trading. On the one hand the setup looks solid. There's no real problem from a conflicting studies standpoint. Even the bearish "island top" study has nearly reached its target in just two days. But there are issues. For one, the market isn't far from my initial entry price, so I'd be taking a larger position without the benefit of scaling in at a much lower price. Secondly, stock moves have generally been strong lately and we appear to be in a heavily news-driven environment. This presents additional risks. Lastly, as I discussed in the intermediate-term section a few days ago, without POMO buying propping up the market, the risk of a substantial downturn is present. So I'm a little bit hesitant to take on much more exposure. Still, with all the bullish evidence we're seeing I think a half-size position is reasonable and therefore I will look to take on more exposure on Wednesday. Entry details are in the trade ideas section further down.

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

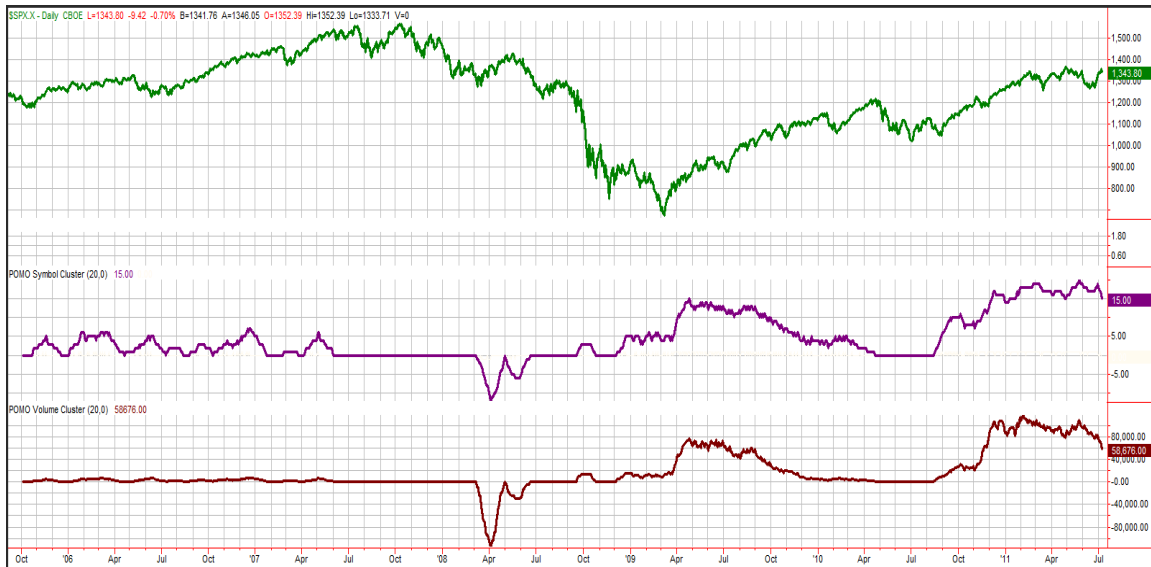
Even with Friday's move lower the major indices managed to post gains for the week and are all nearing their spring highs. Not a lot changed from last week on the intermediate-term front. With QE2 now over the most significant change to the intermediate-term indicators may be the rapid decline that has 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 @ \$131.40 limit. Based on Aggregator and short-term outlook above. I'm looking to enter the 2nd part of my position at a limit price equal to Tuesday's close.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	7/12/2011	\$131.69	\$131.40	-0.22%		bought on open

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