

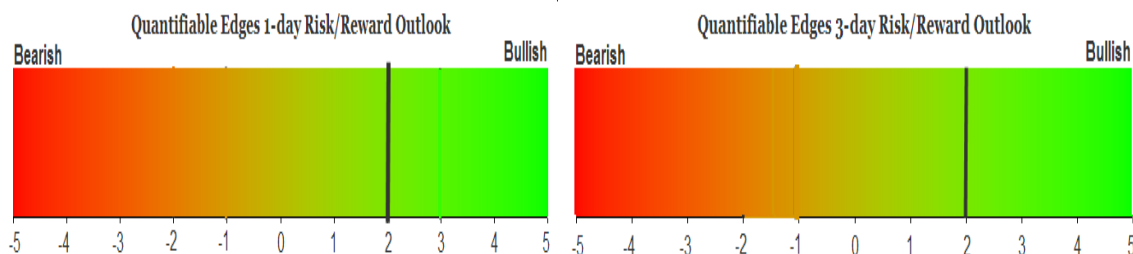
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 14, 2011

Volume 4 Issue 134

Market Overview



Signals Overview

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

Tonight's Research Points

- No new compelling evidence appeared tonight.

Short-term Outlook

The Bottom Line

While the Aggregator is still positive, the market has not bounced the last 2 days as it "should" have. This has me a bit more cautious than I was feeling the last couple of days.

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 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	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 5, 2011	3 days higher. Up vol % > 90% today.	1-7 days	Bullish	2.90%
July 12, 2011	Up Vol < 5%. SPX > 10-low / 200ma	1-2 days	Bullish	2.80%

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

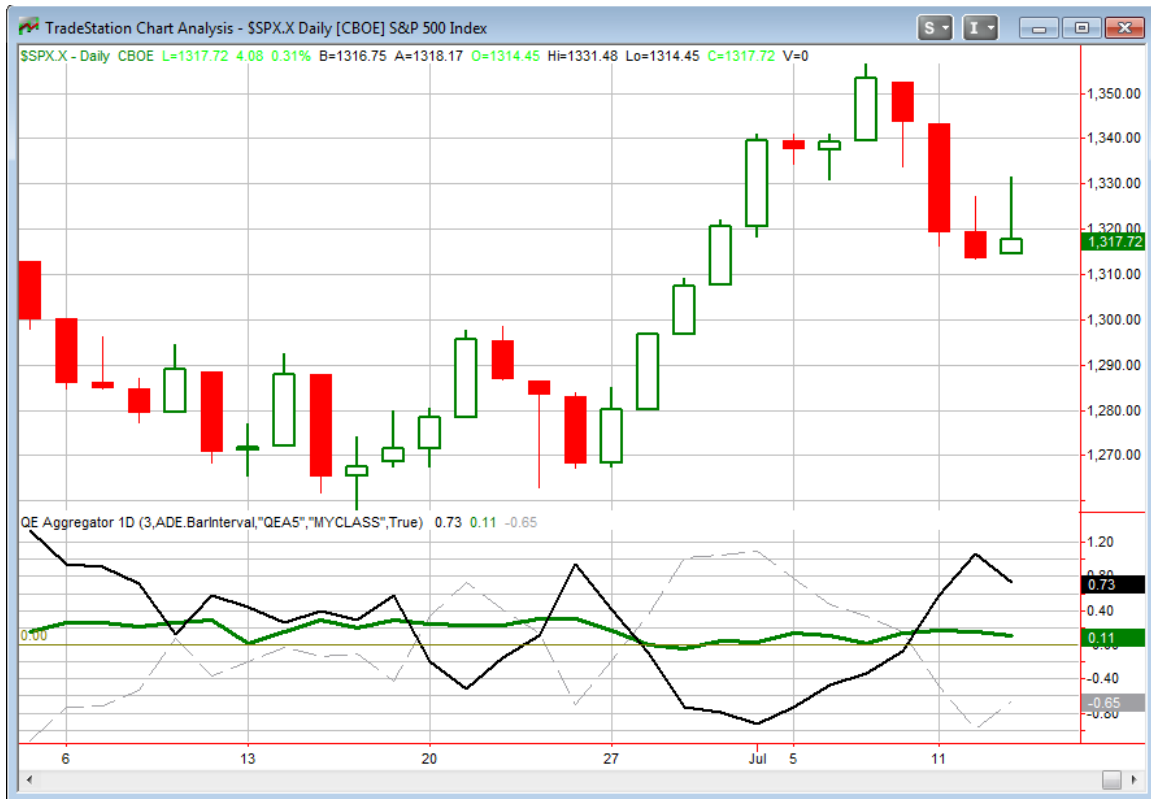
The Evidence

I was out of the office on Wednesday. I checked the market at around 11am and the SPX was up 1.3%. I then checked it again at 1pm and ran the Quantifinder. It was still up strongly. When I checked just before the close I thought “Ugh. That doesn’t look good.” The SPX had given up almost all of its gains and closed up just 0.3%. The Nasdaq and Russell managed a little better and finished +0.5% and +0.9%. Still, they were far from their peaks. Breadth numbers still came out fairly strong with the NYSE Up Issue % at 64% and the Up Volume at 69% (but down from over 90% intraday). Total volume pulled back just a little from yesterday’s level.

Nothing directionally compelling appeared in the Quantifinder tonight, which surprised me with such volatile action. I found it interesting that after being oversold the market attempted a strong bounce during the day Wednesday but mostly failed. While it closed positive the close was in the bottom 20% of the day’s range. I decided to expand the range slightly and look at other times the SPY closed positive after at least 3 down days, but that close was in the bottom 25% of the day’s range. The surprising thing to me was the extremely low number of instances. It only occurred 11 times since 1993. The results didn’t appear indicative of anything. I adjusted the parameters and looked at this concept of up closes that finished near their lows in the context of the current situation a number of ways. I found nothing compelling in the ways I looked at it.

Still, while you’ll see below that the Aggregator is still bullish, I’m having concerns about this bounce. For 2 days we saw pretty substantial evidence that the market should rise and it hasn’t managed to do so. Certainly acting out of character for 2 days isn’t a huge red flag, but it’s enough to make me step back a minute and reconsider how aggressive I want to be trading right now. In addition to acting a bit outside of historical norms the last couple of days, the price action has become increasingly news-driven as events out of Europe and Fed policy musings have been wreaking havoc. The bottom line is that risk appears elevated, Wednesday provided no additional bullish evidence, and I’m not inclined to get aggressive without further compelling upside evidence.

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 Differential Line is also well 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 Thursday. This is unlikely to change. Meanwhile, the Differential Pivot will be 1,323.69. This is about 0.5% above Wednesday's close. So a close higher of this amount would flip the Differential line negative and remove the Aggregator long signal.

As I mentioned above I have some reservations about the current signal. Due to the gap up on Wednesday that never filled I still only have a ¼ size index position in the SPY. While I have reservations about the setup, up still appears to be the more likely short-term direction so I am ok with maintaining the small position for now. Should the market manage to rally and close above the Differential Pivot on Thursday then I will be looking

to exit this small position at the close. I don't intend to increase my exposure to the long side until I see additional compelling bullish evidence, and Wednesday didn't bring any.

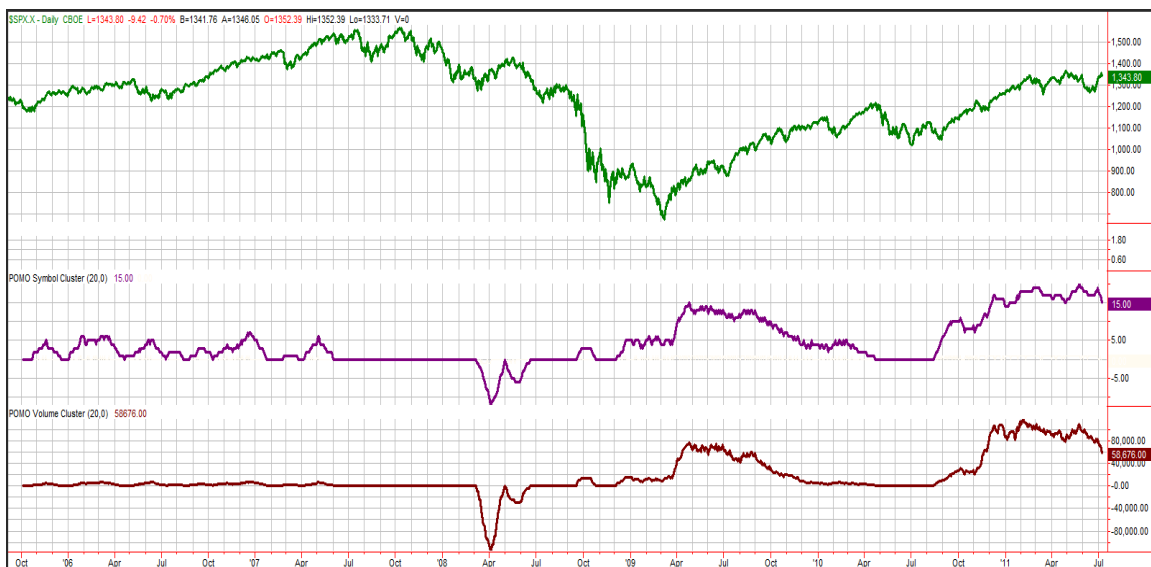
Intermediate-term Outlook (2 weeks – 2 months)– updated 7/11 – mildly bullish

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 be 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.

None tonight. There was no fill Wednesday and at this point I'm inclined to simply maintain the small position. This could change in the next few days if more bullish evidence emerges.

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%		sell on SPX close > 1,323.68

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