

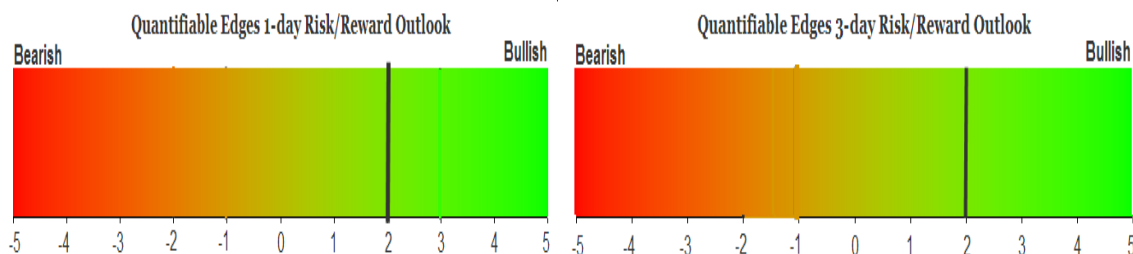
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 15, 2011

Volume 4 Issue 135

Market Overview



Signals Overview

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

Tonight's Research Points

- Nothing new tonight. We seem to be having a mini-drought in bullish studies, but action in the VIX is nearing a level that would signal a likely reversal.

Short-term Outlook

The Bottom Line

The market continues to act weak despite short-term evidence suggesting a bounce is more likely. I have a small long position and am not likely to increase it at this point.

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 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	Island Top	1-8 days	Bearish	-2.40%
July 11, 2011	Worst breadth & volume in 3 weeks	1-4 days	Bullish	1.90%

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

The Evidence

Thursday was another good-looking start that turned into another failed attempt to rally. The major indices all had substantial down days. The SPX lost 0.7%, the NASDAQ was down 1.2%, and the Russell 2000 fell 1.6%. Breadth was again weak as the NYSE Up Issues % came in at 20% and the Up Volume % was 18%. Total NYSE volume rose and appears to have registered the highest reading so far in July.

Most striking about the selloff to me is that we once again did not trigger any bullish studies. This is the third day in a row that the market tried to rally but failed. The inability of the market put together a sustainable rally and the lack of compelling bullish evidence is a worrisome combination. The one bit of "good" news was that the bearish "island top" pattern from last week reached its objective and has been removed from the Active Studies List.

Though it didn't close there, the VIX did spike to more than 20% above its 10ma intraday. I looked at spikes of this magnitude in the 5/5/10 subscriber letter and found that the edge doesn't really kick in until the VIX closes more than 25% above its 10ma. Below is an excerpt from that letter.

There were also a few studies from the Quantifinder that related to the VIX spike. Tuesday the VIX closed about 22% above its 10ma. We actually just saw a study in the April 28th letter that looked at VIX spikes more than 25% above the 10ma. I've updated that study below:

VIX crosses over 25% above its 10ma on a closing basis SPX closes > 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1990 - 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	16,163.14	15	9	6	60.00	2,524.25	-1,092.51	2.31	3.47	1,077.54
4	19,804.91	16	11	5	68.75	2,196.88	-872.16	2.52	5.54	1,237.81
3	14,834.05	16	13	3	81.25	1,338.07	-853.62	1.57	6.79	927.13
2	17,671.44	16	12	4	75.00	1,602.16	-388.62	4.12	12.37	1,104.47
1	16,603.76	16	15	1	93.75	1,151.17	-663.78	1.73	26.01	1,037.74

Results here were strongly suggestive of a short-term bounce. The studies in the Quantifinder tonight looked at instances above 20%. They also suggested short-term strength. But those of course included all of these instances. What if I looked at times like the present when the VIX spiked up to over 20% above the 10ma, but didn't reach the 25% threshold?

VIX crosses over 20% above its 10ma on a closing basis but does NOT close more than 25% above its 10ma. SPX closes > 200ma.
Buy SPX on close. Sell X days later. \$100k/trade. 1990 - 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: WinLoss Ratio	All: ProfitFactor	All: Avg Trade
5	15,430.15	18	13	5	72.22	1,645.00	-1,190.97	1.38	3.59	857.23
4	4,727.26	18	12	6	66.67	1,321.51	-1,855.14	0.71	1.42	262.63
3	-2,747.68	21	13	8	61.90	863.84	-1,747.20	0.49	0.80	-130.84
2	6,053.33	21	13	8	61.90	1,010.25	-884.98	1.14	1.86	288.25
1	3,098.51	21	13	8	61.90	761.79	-850.59	0.90	1.46	147.55

What we see here are relatively mild bullish implications. It's nothing to get excited about and nothing I would base a trade on. I'd rather wait for the 25% spike before putting much weight on this kind of study.

So with the VIX seemingly starting to spike I'll be on the lookout for a move above the 25% threshold in the next couple of days. Should this occur, I will look to take advantage of it through a long XIV position.

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



Though no new studies emerged, the fulfillment of the bearish "island top" study caused the green Aggregator line to move even more positive. 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.

Without any bearish short-term studies the green Aggregator line is again set to close above 0 on Friday. This is unlikely to change unless strongly compelling bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,319.61. This is about 0.8% above Thursday's close. So a close higher of this amount would flip the Differential line negative and remove the Aggregator long signal.

My concerns about the current market have not subsided and the lack of bullish evidence leaves me with no desire to increase my position at this point. The spiking VIX could provide a bullish spark. I will put an XIV order out there that will trigger if the VIX spike accelerates and closes over the 25% threshold. I'm not looking to add more SPY at this time but still feel a modest ¼ position is appropriate.

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

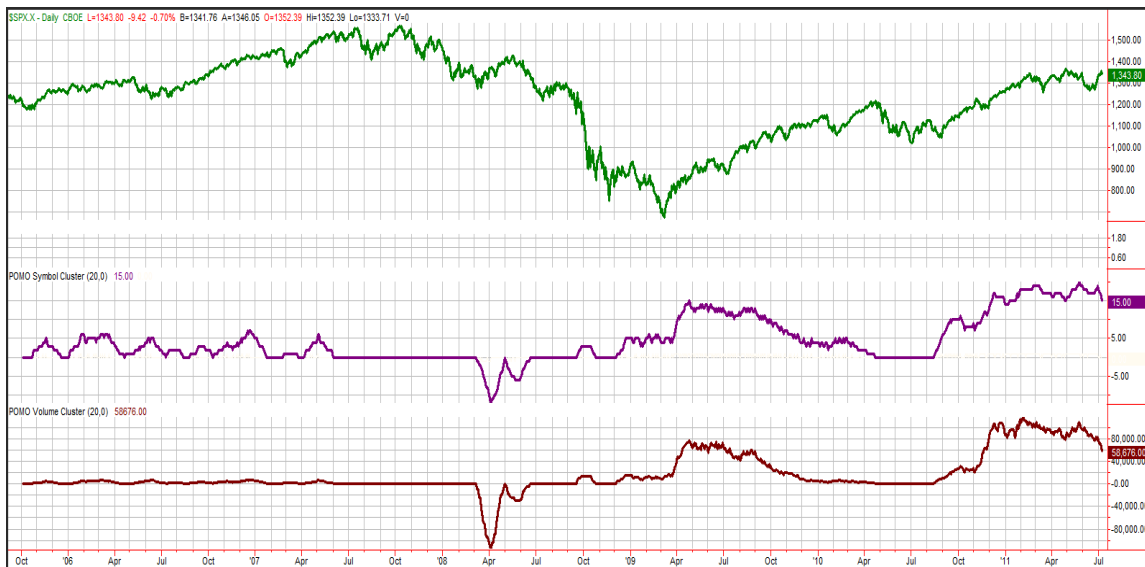
Even with Friday's move lower the major indices managed to post gains for the week and are all nearing their spring highs. Not a lot changed from last week on the intermediate-term front. With QE2 now over the most significant change to the intermediate-term indicators may be the rapid decline that has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

***XIV – buy on close if VIX is trading > 25% above its 10ma at 4:00pm.** As discussed above a spike of this magnitude would contain a strong chance of a sharp reversal. If it happens I'll be looking to position myself to take advantage of it.*

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	7/12/2011	\$131.69	\$130.93	-0.58%		sell on SPX close > 1,319.60

Should we rally and close above the Differential pivot I will exit the SPY trade idea at the close.

This report has been prepared by Hanna Capital Management, LLC and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy securities. While information contained herein is believed to be accurate at the time of publication, we make no representation as to the accuracy or completeness of any data, studies, or opinions expressed and it should not be relied upon as such. Robert Hanna, Hanna Capital Management, LLC or clients of Hanna Capital Management, LLC may have positions or other interests in securities (including derivatives) directly or indirectly which are the subject of this report. This report is provided solely for the information of Hanna Capital Management, LLC clients and prospects who are expected to make their own investment decisions without reliance upon this report. Neither Hanna Capital Management, LLC nor any officer or employee of Hanna Capital Management, LLC accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report may not be reproduced, distributed or published by any recipient for any purpose without the prior express consent of Hanna Capital Management, LLC.

Copyright © 2011 Hanna Capital Management, LLC.