

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 21, 2011

Volume 4 Issue 139

Market Overview



Signals Overview

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

Tonight's Research Points

- The low SPY volume was once a reliable bearish indication. In recent years under similar circumstances it has not suggested an edge.

Short-term Outlook

The Bottom Line

Other than the date, nothing changed today. The market is still modestly overbought and with the short-term active list empty, intermediate-term studies have the Aggregator slightly positive. I'm neutral and awaiting a more favorable entry opportunity.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
None				
Active - Long Term				
July 5, 2011	QE2 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	

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

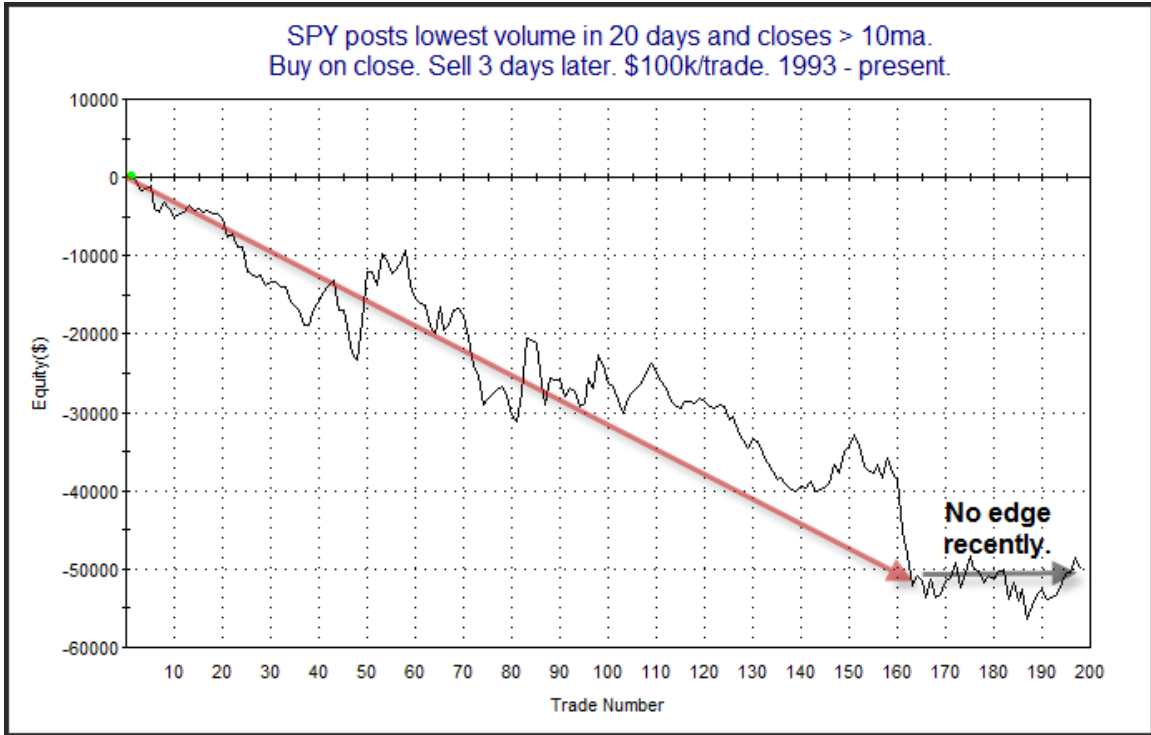
The Evidence

The market wiggled around the breakeven line for much of the day on Wednesday. Some late selling pushed the SPX down to join the other major indices in negative territory. In the end the SPX lost less than 0.1%, while the Nasdaq was down 0.4% and the Russell 2000 lost 0.3%. NYSE breadth finished mildly positive though, with the Up Issues % coming in at 55% and the Up Volume % at 58%. Total NYSE volume declined and came in light.

Where volume action really stood out was with SPY, which posted its lowest volume in over a month. With SPY closing above its 10ma, a study from the 9/8/10 Subscriber Letter was triggered. I have updated that study below.

SPY posts lowest volume in 20 days and closes > 10ma. 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
10	-23,405.66	150	83	67	55.33	2,230.21	-3,112.13	0.72	0.89	-156.04
9	-28,986.08	155	92	63	59.35	1,950.18	-3,307.98	0.59	0.86	-187.01
8	-15,899.27	164	96	67	58.54	1,923.66	-2,993.60	0.64	0.92	-96.95
7	-25,379.39	167	89	77	53.29	1,819.85	-2,433.07	0.75	0.86	-151.97
6	-41,740.61	170	84	85	49.41	1,693.53	-2,164.68	0.78	0.77	-245.53
5	-69,420.20	181	84	96	46.41	1,534.45	-2,065.77	0.74	0.65	-383.54
4	-48,068.07	191	95	96	49.74	1,282.69	-1,770.04	0.72	0.72	-251.67
3	-50,099.45	198	85	112	42.93	1,299.24	-1,433.35	0.91	0.69	-253.03
2	-39,471.64	211	92	118	43.60	1,082.49	-1,178.48	0.92	0.72	-187.07
1	-38,892.15	240	104	135	43.33	750.25	-866.06	0.87	0.67	-162.05

The stats table appears to suggest possible bearish implications. But it is always important to see how the edge has evolved. Based on the % profitable, avg. trade, and profit factor columns it appears much of the downside edge is realized by day 3. So below is an equity curve using a 3-day holding period.



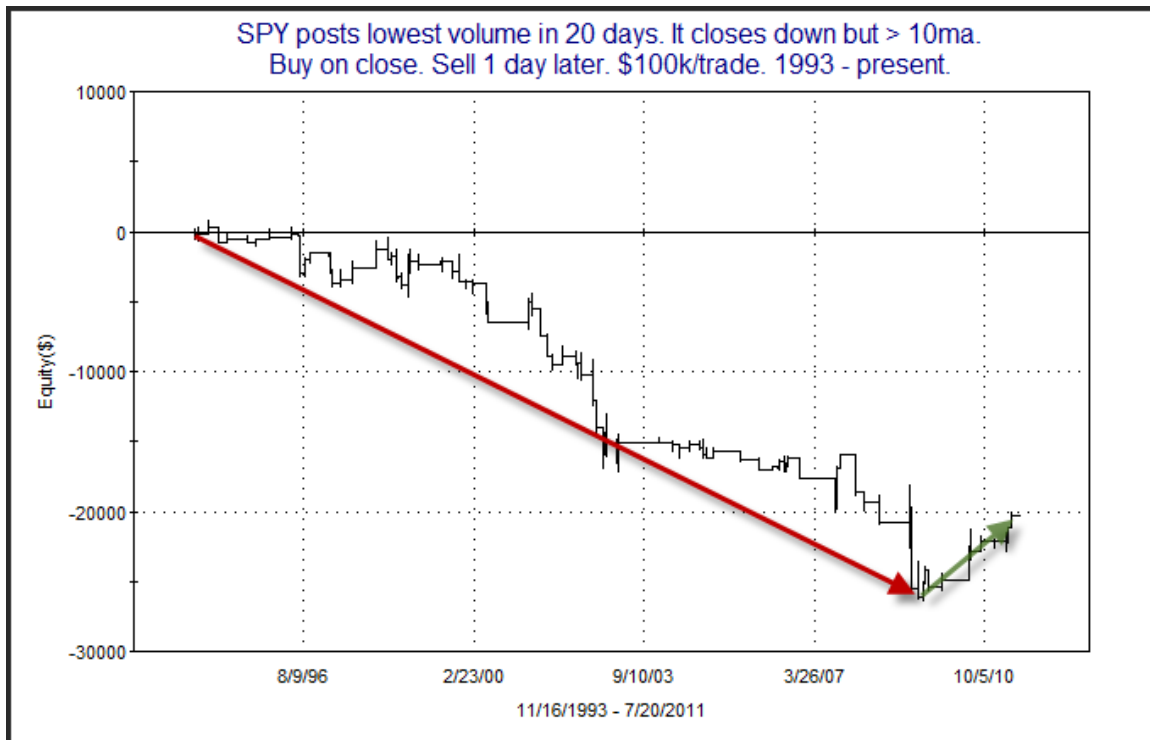
What we see here is that over the last 35 or so instances there has been no apparent downside edge. I looked at other holding periods as well and found this to be the case among all of them. This would seem to eliminate this study from inclusion on the Active List.

Still, I thought it worth considering that the setup occurred on a down day. I decided to filter on those occasions where this had occurred in the past.

SPY posts lowest volume in 20 days. It closes down but > 10ma.
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
10	3,168.98	75	45	30	60.00	2,264.72	-3,291.45	0.69	1.03	42.25
9	-4,432.42	76	43	33	56.58	2,290.09	-3,118.37	0.73	0.96	-58.32
8	-2,367.80	79	44	34	55.70	2,386.45	-3,157.99	0.76	0.98	-29.97
7	11,639.80	79	44	35	55.70	2,154.40	-2,375.82	0.91	1.14	147.34
6	-16,548.10	79	42	37	53.16	1,747.88	-2,431.32	0.72	0.82	-209.47
5	-13,043.27	79	38	40	48.10	1,777.34	-2,014.55	0.88	0.84	-165.10
4	463.70	82	41	41	50.00	1,689.86	-1,678.55	1.01	1.01	5.65
3	2,196.71	83	41	41	49.40	1,503.77	-1,450.19	1.04	1.04	26.47
2	3,488.45	84	42	42	50.00	1,240.67	-1,157.62	1.07	1.07	41.53
1	-20,306.10	87	38	49	43.68	645.82	-915.25	0.71	0.55	-233.40

Results here are much more neutral than shown in the 1st test. The only time frame in which a worthwhile edge seems likely is the 1-day hold. So below is an equity curve with a 1-day exit strategy.



The equity curve here isn't far from the 1st one I showed. Since the 2009 bottom the setup has actually been followed by positive returns the following day.

No matter how I slice it, the low SPY volume doesn't seem to be suggesting a bearish edge in the current environment. This again is leaving us with nothing but intermediate-term studies with which to base estimates on.

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



With just the intermediate-term studies left the green Aggregator line is still only mildly positive. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the Differential Line remains below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are positive and the SPX is overbought versus recent expectations. This is considered a neutral configuration. It can be seen on the Aggregator chart whenever both lines are on opposite sides of 0. Due to this the Aggregator System remained flat at the close.

Without any bearish short-term studies the green Aggregator line is again set to close above 0 on Thursday. This could easily change if compelling bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,308.85. This is about 1.3% below Wednesday's close. So it would take a decline of at least this much to flip the Differential Line back to positive and possibly trigger another long signal.

There has been no substantial change since yesterday. Short-term evidence is lacking. The market is mildly overbought versus expectations. And today's mild selloff kept the SPX right near the middle of its 10-day range. Mid-range is my least favorite place to establish new positions. Staying sidelined for another day is a no-brainer for me. I'll demand a more pronounced edge before taking on directional bets.

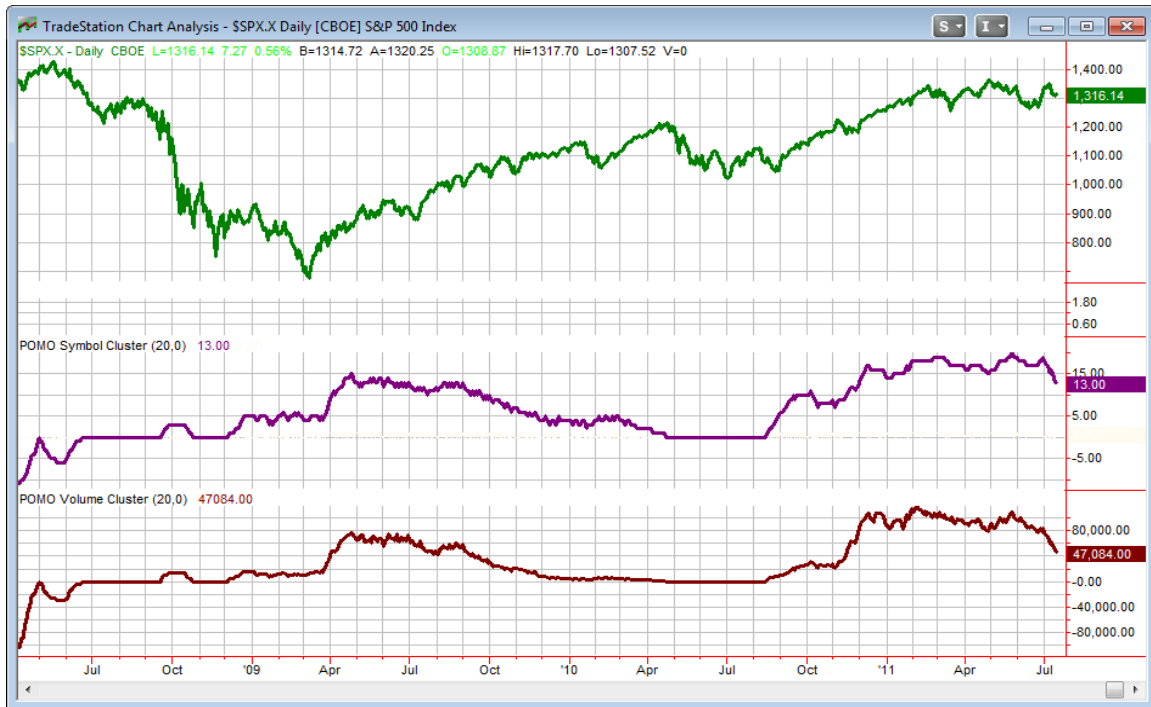
Intermediate-term Outlook (2 weeks – 2 months)– updated 7/11 – mildly bullish

It was a fairly tough week for the market. After entering the week close to new highs, the SPX pulled back near the middle of its May-June trading range. Not much showed up with intermediate-term implications.

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>



Even with QE2 now over there were 2 days of POMO buying this past week. In looking at the upcoming schedule it appears 2 days a week may be par for the course for a while. So even without QE2, there will still be a decent amount of liquidity pumping occurring. It certainly isn't at the levels that the market was accustomed to, but it does not appear the POMO indicators above will be hitting 0 any time soon. The "Days" indicator may even settle in around 7-8, which is far higher than I anticipated. Below is a copy of the upcoming schedule.

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

I had been considering the end of QE2 as a strongly negative market influence, but perhaps I should be considering it mildly bearish to neutral at this point. After being used to massive amounts of liquidity, I certainly don't think the current POMO schedule will act as a positive. I thought I might be phasing out this chart for a while, but I think it will still be important to monitor for a while.

There remain a number of intermediate-term market positives that can be pointed to. 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 slightly favoring the bull side for the time being.

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.](#) Even the triggers page was mostly barren.

Current Open Trade Ideas

None.

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