

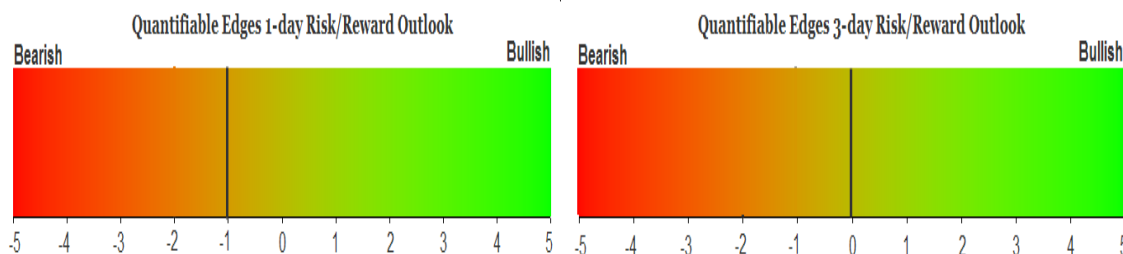
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 25, 2011

Volume 4 Issue 141

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- Extremely weak volume while the SPX is making a new short-term high has been followed by short-term weakness in the past.

## Short-term Outlook

### The Bottom Line

I'm seeing evidence suggesting a short-term downside edge, but it isn't quite strong enough to turn the Aggregator negative. With the SPX still overbought, I am sidelined and awaiting a more substantial edge.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
July 25, 2011	10-day high on 20-day low volume	1-2 days	Bearish	-1.10%
July 22, 2011	Up Issue% > 75% 2 of 3. Close 10 high.	1-6 days	Bullish	2.70%
<b>Active - Long Term</b>				
July 22, 2011	Up Issue% > 75% 2 of 3. Close 10 high.	1-20 days	Bullish	5.50%
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***

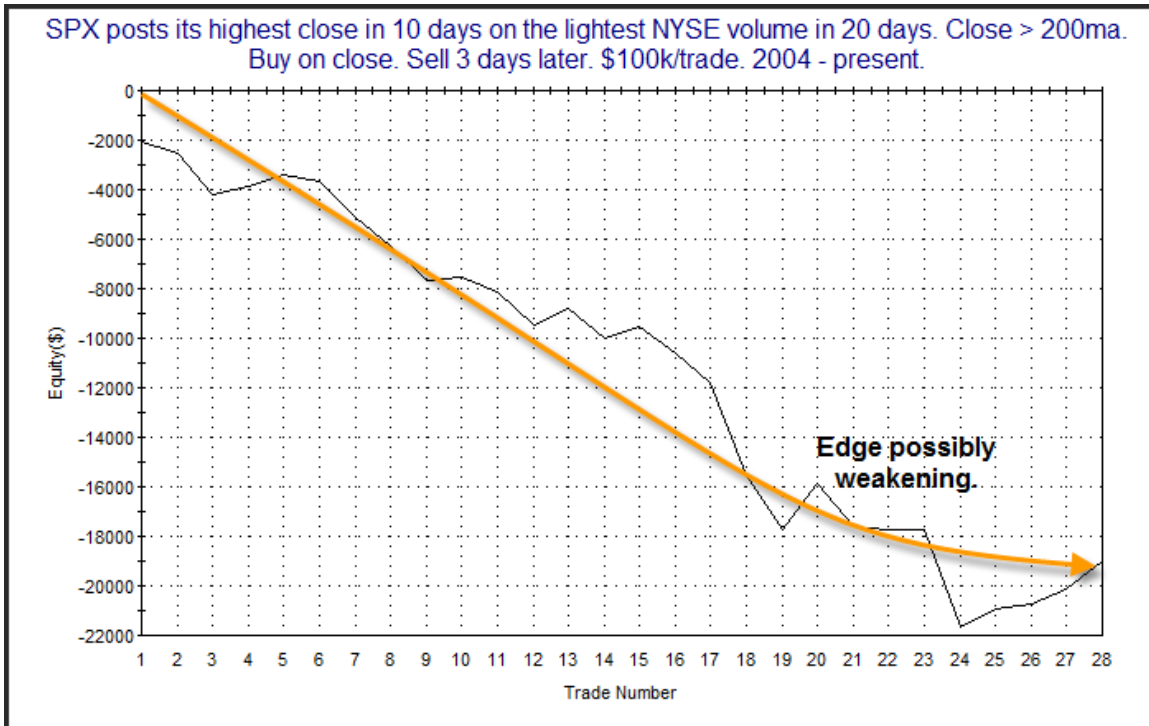
Perhaps New York traders felt it was too hot to trade Friday afternoon, but most of the action was done by 12. The major indices closed mostly higher. The Nasdaq led the way with a 0.9% gain. The SPX and Russell 2000 each gained just under 0.1%. Breadth on the NYSE was slightly negative as the Up Issues % came in at 48% and the Up Volume % was 49%. Total NYSE volume came in at the lightest level since the Friday before Memorial Day.

Very light volume at new highs often indicates the rally is running out of buyers. Frequently such light volume is followed by a pullback in the next few days. There were several studies that appeared in the Quantifinder that demonstrated this point. I've chosen the 2 most relevant to highlight below. They both look at 10-day closing highs and 20-day volume lows. The difference is that one looks at the SPX cash index and NYSE volume, and the other uses SPY. The first one below was last seen in the 3/28/11 subscriber letter and examines SPX prices along with NYSE volume.

SPX posts its highest close in 10 days on the lightest NYSE volume in 20 days. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 2004 - 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	-18,508.11	27	7	20	25.93	1,185.17	-1,340.22	0.88	0.31	-685.49
4	-17,844.28	28	7	21	25.00	787.17	-1,112.12	0.71	0.24	-637.30
3	-19,007.95	28	10	18	35.71	647.32	-1,415.62	0.46	0.25	-678.86
2	-19,034.64	29	10	19	34.48	497.17	-1,263.49	0.39	0.21	-656.37
1	-9,356.37	30	11	19	36.67	189.44	-602.12	0.31	0.18	-311.88

**93% of instances posted at least 1 close below the entry price within the next 4 days.**

Results here suggest bearish implications. The edge appears to be primarily short-term, maxing out around 2-3 days. You'll note the study only goes back to 2004. The reason for that is that prior to this a downside edge was not apparent. Therefore I felt it was important to examine the equity curve for confirmation of the bearish edge suggested by the numbers.



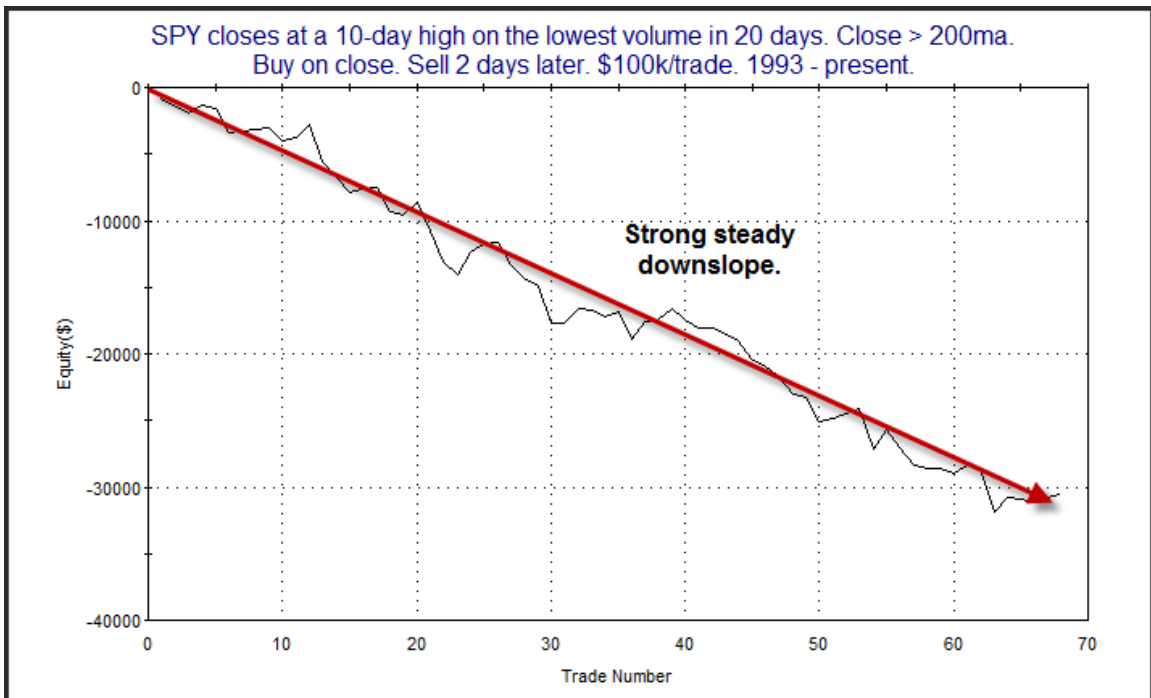
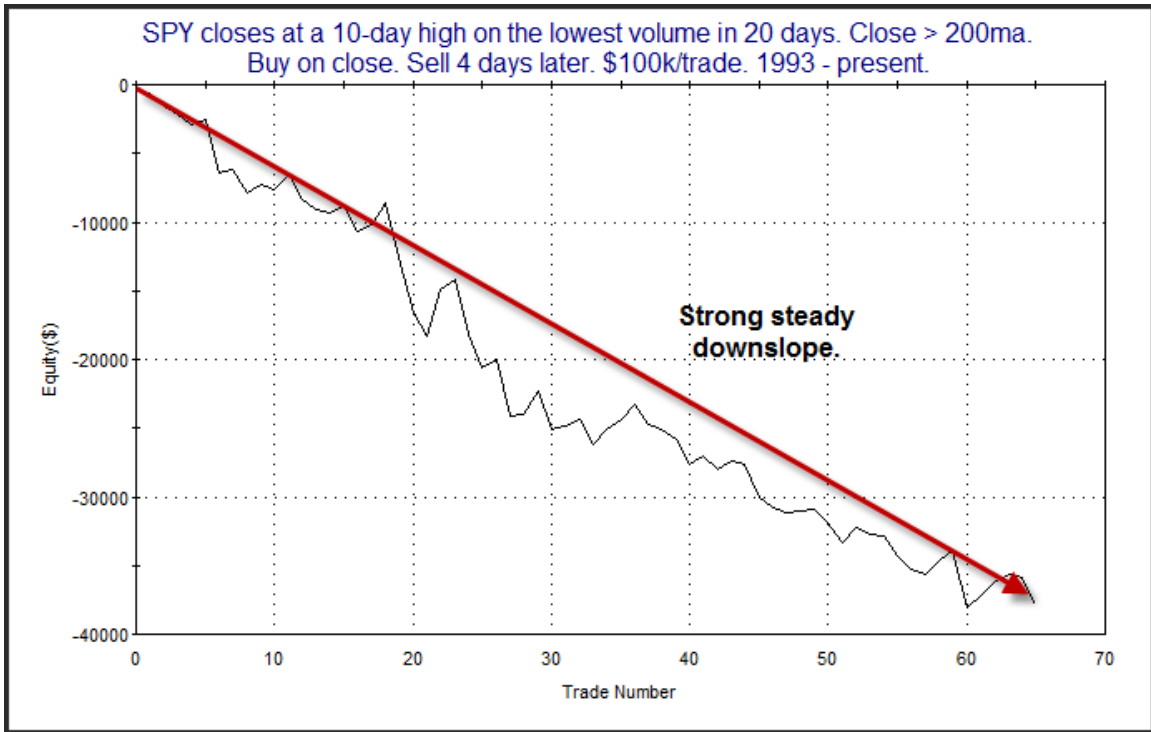
The last few instances have failed to follow suit. This hints that the edge may possibly be weakening and a close eye should be kept on this study going forward. At this point, it still appears the primary slope is down. As a whole, I believe this study is worth taking into consideration.

This next study is very similar but it looks at SPY price and volume. It last appeared in the 4/5/11 subscriber letter. I have updated the results below.

SPY closes at a 10-day high on the lowest volume in 20 days. Close > 200ma.  
Buy on close. Sell X days later. \$100k/trade. 1993 - present.

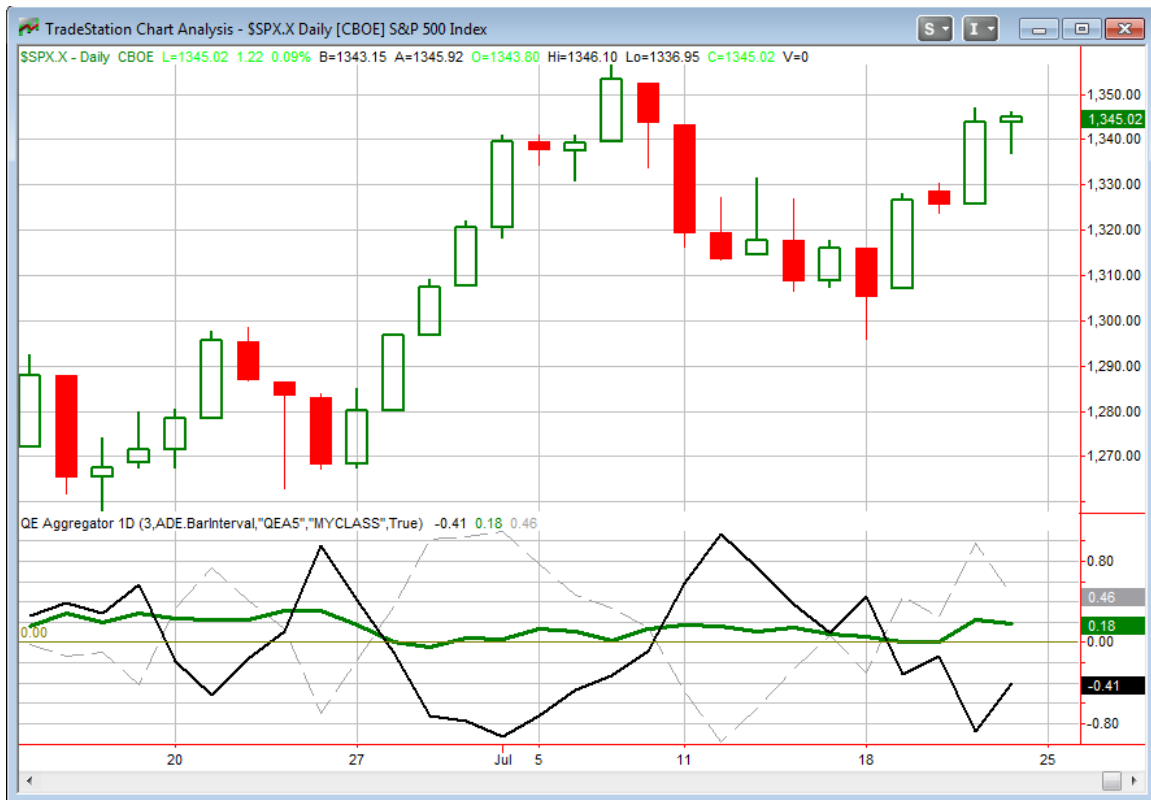
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-23,774.72	64	29	35	45.31	991.11	-1,500.48	0.66	0.55	-371.48
4	-37,794.24	65	27	38	41.54	810.81	-1,570.69	0.52	0.37	-581.45
3	-30,888.82	65	26	39	40.00	727.37	-1,276.93	0.57	0.38	-475.21
2	-30,488.26	68	25	42	36.76	566.58	-1,063.16	0.53	0.32	-448.36
1	-12,223.03	70	24	46	34.29	500.63	-526.91	0.95	0.50	-174.61

This study looks back to the inception of the SPY in 1993. As you'll see below the edge has been quite steady over this entire period. The edge appears to max out after 4 days, though most of it is realized in the 1<sup>st</sup> 2 days. Below are both 4 and 2-day equity curves.



In both cases the edge appears intact. The results are especially impressive considering they were all realized in long-term uptrends.

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



With tonight's bearish studies the green Aggregator line pulled back some but still remained squarely positive. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the Differential Line is still well 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.

With the current studies the green Aggregator line is again set to close above 0 on Monday. This could change if more bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,326.44. This is about 1.4% below Friday'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.

I should note that while the short-term expectations are positive, expectations for Monday are slightly negative. This is reflected at the top of the letter in the 1-day risk/reward outlook. Very aggressive or day-traders could consider looking for a quick short trade on Monday. It isn't something that I factor into my own trading.

Bottom line is that the outlook remains positive over the next few days but the SPX is still too extended. This increases risk. I'll stand aside until either bearish evidence increases or a more favorable entry point avails itself for a long trade.

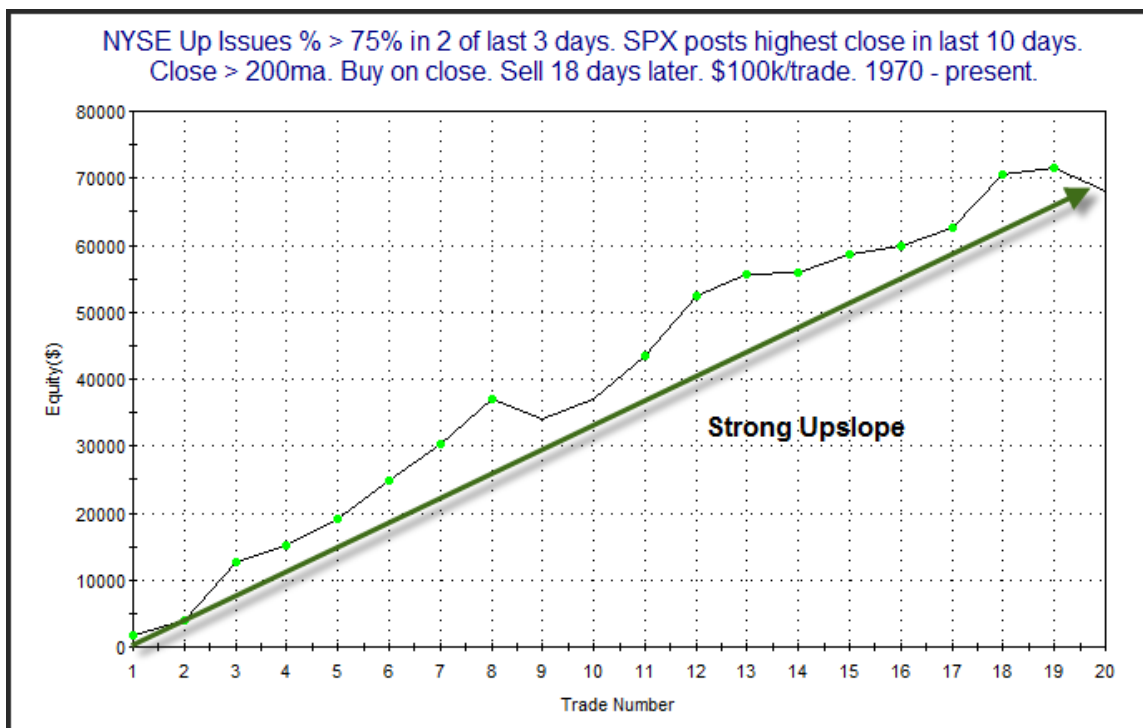
**Intermediate-term Outlook (2 weeks – 2 months)– updated 7/25 – moderately bullish**

After a dip to new short-term lows on Monday the market gathered itself and finished out with a nice week. The SPX is now less than 1% from its July high and within 2% of its May high. An intermediate-term study triggered on Thursday that suggested that these levels should be taken out. Below I have copied the results from Thursday night's letter.

NYSE Up Issues % > 75% in 2 of last 3 days. SPX posts highest close in last 10 days. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1970 - 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
20	72,673.56	19	16	3	84.21	4,912.07	-1,973.20	2.49	13.28	3,824.92
19	70,576.96	20	17	3	85.00	4,593.61	-2,504.78	1.83	10.39	3,528.85
18	68,169.46	20	18	2	90.00	4,150.05	-3,265.74	1.27	11.44	3,408.47
17	65,698.31	20	18	2	90.00	4,089.68	-3,957.99	1.03	9.30	3,284.92
16	64,695.52	20	18	2	90.00	4,015.19	-3,788.93	1.06	9.54	3,234.78
15	54,962.15	20	16	4	80.00	4,043.82	-2,434.73	1.66	6.64	2,748.11
14	50,742.27	20	18	2	90.00	3,381.83	-5,065.35	0.67	6.01	2,537.11
13	48,932.78	21	17	4	80.95	3,442.08	-2,395.64	1.44	6.11	2,330.13
12	48,351.39	22	17	5	77.27	3,423.88	-1,970.90	1.74	5.91	2,197.79
11	50,348.14	22	18	4	81.82	3,193.65	-1,784.37	1.79	8.05	2,288.55
10	45,265.78	22	18	4	81.82	3,002.75	-2,195.91	1.37	6.15	2,057.54
9	43,659.47	22	17	5	77.27	3,118.12	-1,869.70	1.67	5.67	1,984.52
8	38,392.06	22	18	4	81.82	2,516.31	-1,725.40	1.46	6.56	1,745.09
7	38,493.16	22	17	5	77.27	2,580.25	-1,074.22	2.40	8.17	1,749.69
6	39,010.37	23	20	3	86.96	2,145.86	-1,302.27	1.65	10.99	1,696.10
5	32,659.62	23	18	5	78.26	1,996.35	-654.95	3.05	10.97	1,419.98
4	25,157.02	24	19	5	79.17	1,497.08	-657.52	2.28	8.65	1,048.21
3	16,066.83	24	16	8	66.67	1,382.97	-757.59	1.83	3.65	669.45
2	10,142.47	27	17	10	62.96	1,072.59	-809.16	1.33	2.25	375.65
1	5,976.39	29	17	12	58.62	692.62	-483.18	1.43	2.03	206.08

**All 29 instances posted a close above the entry price at some point in the next 6 days.**

The intermediate-term implications appear strongly positive. I showed a short-term equity curve on Thursday. Today I have run an intermediate-term curve, which can be found below.

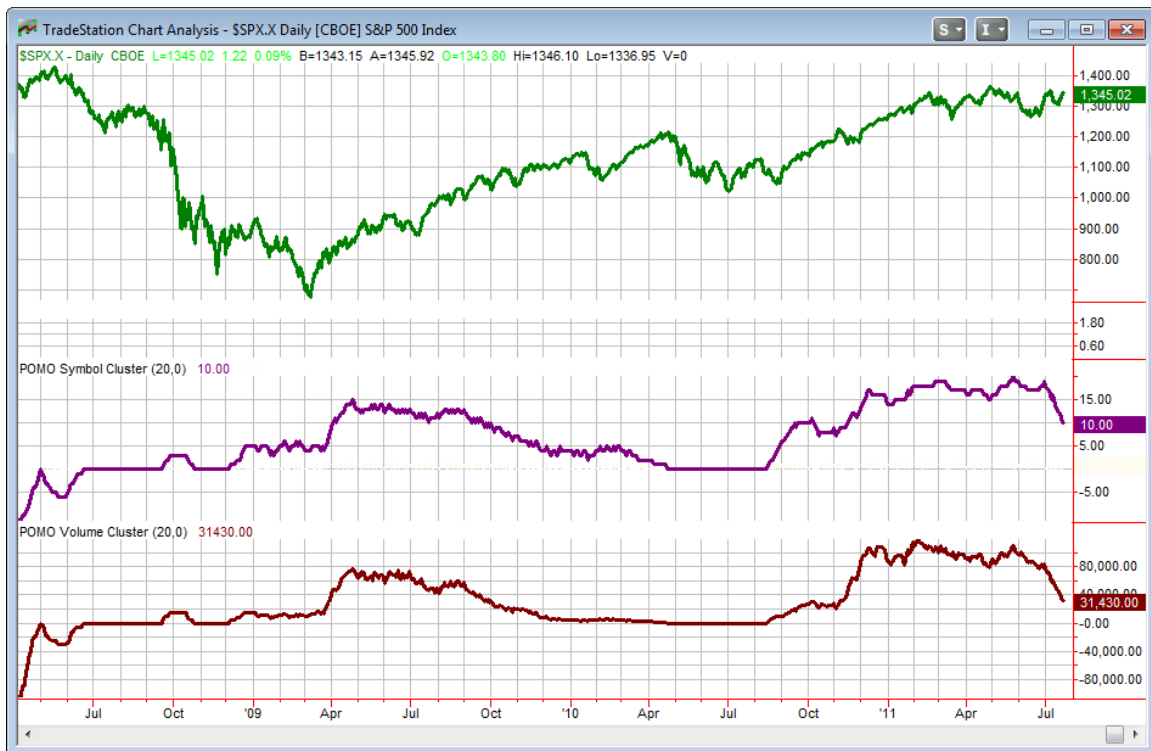


The strong upslope creates greater confidence in the upside edge.

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 3<sup>rd</sup> POMO presentation linked below. (Not available for trial users.)*

<http://www.quantifiableedges.com/members/pomo.php>



There were again 2 days of POMO buying this past week. They were extremely light days from a volume perspective. 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 originally anticipated. Below is a link to the upcoming schedule.

[http://www.newyorkfed.org/markets/tot\\_operation\\_schedule.html](http://www.newyorkfed.org/markets/tot_operation_schedule.html)

With buying so light this past week it will be interesting to see where the POMO volume indicator begins to level off. Action over the next couple of weeks will be especially interesting as the QE2 program completely falls out of the backwards-looking calculation.

There remain a number of intermediate-term market positives that can be pointed to. Breadth seems to be the #1 indication of higher prices. Thursday's study created the 3<sup>rd</sup> active intermediate-term breadth-thrust study. The other 2 were from March 22<sup>nd</sup> and July 5<sup>th</sup>. There is also still a high-probability Follow-Through Day signal active, the

Nasdaq is leading the SPX, and price action and momentum are providing positive indications as well. The big concern remains the rapidly weakening POMO activity. 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.** July has so far produced the lowest number of trade ideas of any month in a very long time. While I wish there was more action, I have learned over the years that times where edges are not readily availing themselves patience is often rewarded and aggressive trading is often punished. So I'll give it another day and see if anything compelling presents itself on Monday.*

### **Current Open Trade Ideas**

*None.*

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