

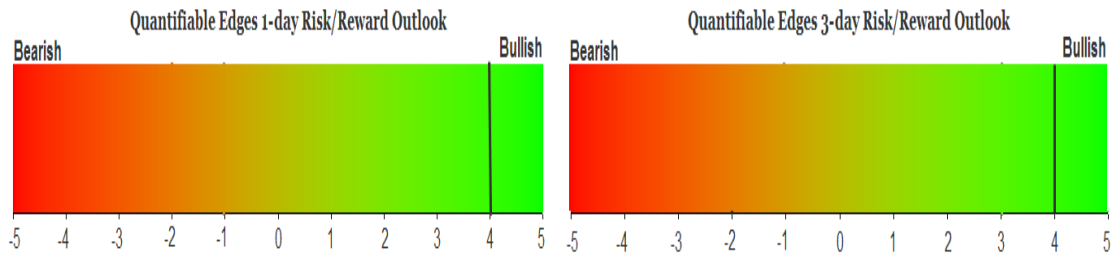
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 29, 2011

Volume 4 Issue 145

Market Overview



Signals Overview

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

Tonight's Research Points

- A drop of less than 0.5% after a drop of 1.75% suggests a short-term bullish edge.
- 4 lower lows and a 20-day low has commonly been followed by a bounce.

Short-term Outlook

The Bottom Line

The market remains primed for a bounce and I am positioned to take advantage of it.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
July 29, 2011	4 lower lows. 20-day low. Close >200	1-8 days	Bullish	2.40%
July 28, 2011	2% drop. Weak close.	1-3 days	Bullish	
July 28, 2011	system 110524	1-6 days	Bullish	
July 28, 2011	3 dn. Big drop.	1-5 days	Bullish	
July 22, 2011	Up Issue% > 75% 2 of 3. Close 10 high.	1-6 days	Bullish	2.70%
Active - Long Term				
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	
Dropped Tonight				
July 28, 2011	Extremely low TICK	1 day	Bullish	
July 28, 2011	50ma cross. 90% down vol.	1 day	Bullish	

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

The Evidence

According to the evidence I reviewed Wednesday night, the market was “supposed” to rally on Thursday. And at noon everything was looking up. But the afternoon was tough and all the early gains were given back and more, which left the final numbers mixed. The SPX lost 0.3% and the Russell 2000 was down 0.2% while the Nasdaq gained less than 0.1%. Breadth was solidly negative as the NYSE Up Issues % came in at 37% and the Up Volume % was 35%. Total NYSE volume dipped from Wednesday’s levels.

Though the evidence is not as compelling as we saw last night, several studies appeared in the Quantifinder suggesting this pullback is nearing at least a temporary bottom. Below are some of the more compelling studies that triggered.

This first one examines what happens when a sharp drop decelerates and the SPX is in a long-term uptrend. It last appeared in the 6/3/11 subscriber letter. I have updated all stats below.

After dropping over 1.75% yesterday SPX falls less than 0.5% today. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1988 - 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	39,080.57	16	13	3	81.25	3,429.31	-1,833.49	1.87	8.10	2,442.54
9	38,375.17	16	14	2	87.50	3,132.84	-2,742.30	1.14	8.00	2,398.45
8	40,881.06	16	13	3	81.25	3,380.13	-1,020.19	3.31	14.36	2,555.07
7	30,195.91	16	13	3	81.25	2,612.45	-1,255.30	2.08	9.02	1,887.24
6	18,296.79	16	11	5	68.75	2,289.49	-1,377.53	1.66	3.66	1,143.55
5	20,216.07	16	12	4	75.00	2,156.99	-1,416.95	1.52	4.57	1,263.50
4	13,015.02	16	10	6	62.50	2,226.81	-1,542.18	1.44	2.41	813.44
3	11,055.00	16	11	5	68.75	1,588.01	-1,282.62	1.24	2.72	690.94
2	6,199.33	16	9	7	56.25	1,381.62	-890.74	1.55	1.99	387.46
1	-20.72	16	10	6	62.50	693.69	-1,159.60	0.60	1.00	-1.29

These results appear very strong and steady, especially over the 7-10 day period. Below I have listed all instances using an 8-day holding period.

After dropping over 1.75% yesterday SPX falls less than 0.5% today. SPX > 200ma.
Buy on close. Sell 8 days later. \$100k/trade. 1988 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
11/14/88	Buy	\$267.71	(0.18%)	\$690.05
11/25/88	Sell	\$267.22		(\$1,812.78)
12/19/89	Buy	\$342.45	5.03%	\$5,031.16
01/02/90	Sell	\$359.68		(\$192.72)
06/25/91	Buy	\$370.64	1.97%	\$1,961.01
07/08/91	Sell	\$377.93		(\$718.23)
02/17/93	Buy	\$433.30	2.01%	\$2,500.10
03/01/93	Sell	\$442.01		(\$1,161.50)
04/09/96	Buy	\$642.19	0.45%	\$795.15
04/19/96	Sell	\$645.06		(\$2,797.75)
04/28/98	Buy	\$1,085.11	2.12%	\$4,177.72
05/08/98	Sell	\$1,108.14		(\$42.32)
01/13/99	Buy	\$1,234.40	1.45%	\$3,214.08
01/26/99	Sell	\$1,252.31		(\$2,018.52)
08/31/99	Buy	\$1,320.41	1.80%	\$3,073.50
09/13/99	Sell	\$1,344.13		(\$1,170.75)
05/04/00	Buy	\$1,409.47	4.01%	\$4,265.10
05/16/00	Sell	\$1,466.04		(\$2,403.10)
05/22/00	Buy	\$1,400.72	5.46%	\$5,858.21
06/02/00	Sell	\$1,477.26		(\$2,813.73)
05/20/03	Buy	\$919.73	5.14%	\$6,413.04
06/02/03	Sell	\$967.00		(\$520.56)
06/06/06	Buy	\$1,263.85	(0.97%)	\$680.98
06/16/06	Sell	\$1,251.54		(\$3,520.24)
09/02/09	Buy	\$994.75	5.82%	\$6,129.00
09/15/09	Sell	\$1,052.63		(\$250.00)
10/02/09	Buy	\$1,025.21	6.52%	\$6,592.12
10/14/09	Sell	\$1,092.02		\$0.00
06/02/11	Buy	\$1,312.94	(1.91%)	\$0.00
06/14/11	Sell	\$1,287.87		(\$3,594.80)
07/12/11	Buy	\$1,313.64	2.39%	\$2,535.36
07/22/11	Sell	\$1,345.02		(\$1,346.72)

The results here appear to be consistently strong. The only issue is that the number of instances is a little on the low side.

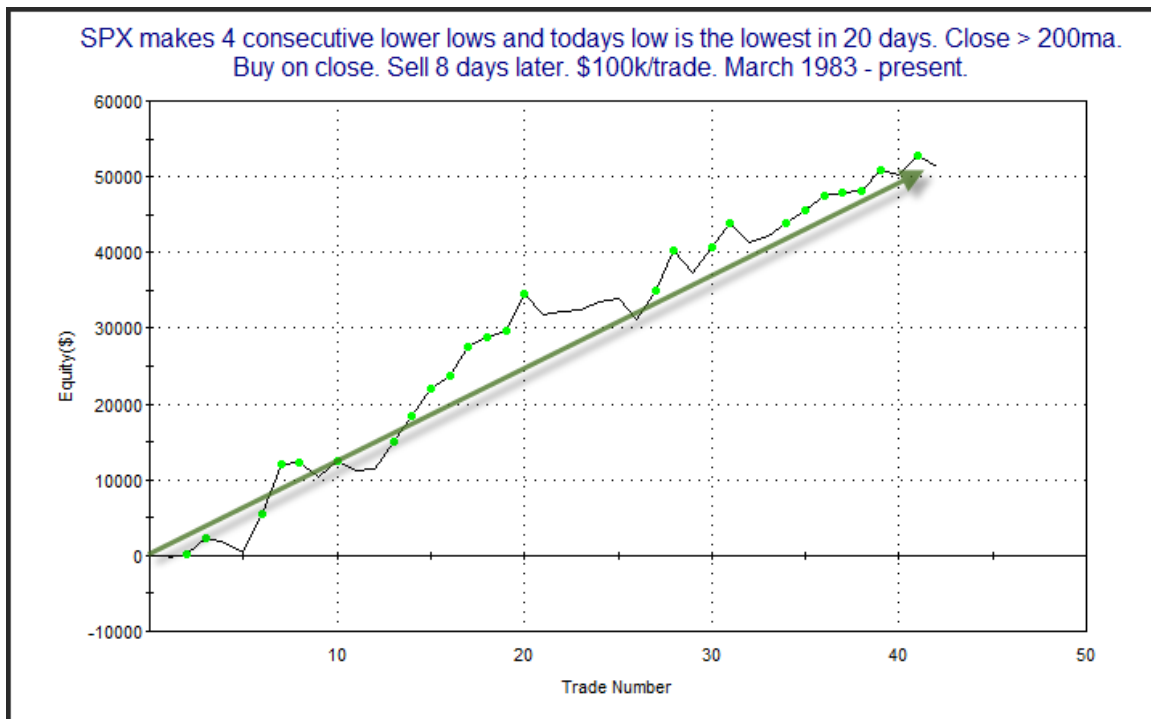
This next study considered the continually lower lows we've been seeing. It last appeared in the 6/7/11 subscriber letter. Stats are updated.

SPX makes 4 consecutive lower lows and today's low is the lowest in 20 days. Close > 200ma.
Buy on close. Sell X days later. \$100k/trade. March 1983 - 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	47,620.94	42	29	13	69.05	2,245.12	-1,345.20	1.67	3.72	1,133.83
9	49,550.21	42	31	11	73.81	2,211.78	-1,728.63	1.28	3.61	1,179.77
8	51,320.81	42	31	11	73.81	2,255.63	-1,691.25	1.33	3.76	1,221.92
7	48,315.96	42	28	14	66.67	2,202.09	-953.04	2.31	4.62	1,150.38
6	39,416.23	43	32	11	74.42	1,660.13	-1,246.18	1.33	3.88	916.66
5	26,854.25	43	27	16	62.79	1,648.03	-1,102.66	1.49	2.52	624.52
4	25,743.54	43	26	17	60.47	1,629.97	-978.57	1.67	2.55	598.69
3	11,641.48	43	23	20	53.49	1,273.50	-882.45	1.44	1.66	270.73
2	10,664.19	43	24	19	55.81	993.46	-693.63	1.43	1.81	248.00
1	2,022.44	43	27	16	62.79	605.80	-895.88	0.68	1.14	47.03

38 of 43 instances (88%) closed above the entry price at some point in the next week.

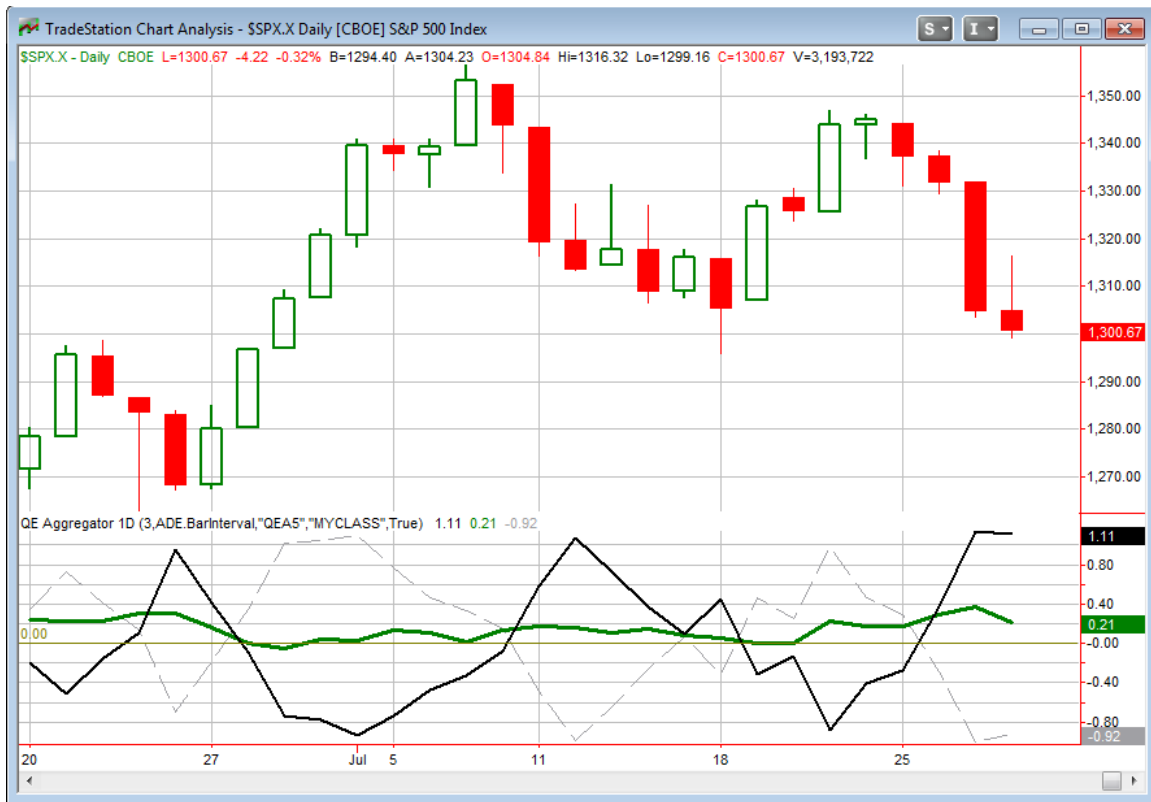
Results above suggest a solid bullish short-term edge. To see how it has played out over the years I have included below an equity curve assuming an 8-day exit strategy.



The strong, steady rise helps to confirm the upside edge suggested by the stats table. Since both studies are fixed on price action and both suggest short-term implications of

about 8 days, I chose this one to include in the Aggregator. I did this because the estimates would be based on a more substantial number of trades and a smoother equity curve.

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



Evidence isn't as compelling as last night but the green Aggregator line is still solidly positive. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the Differential Line remains about as far above 0 as it has been in a long time. 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 provided a bullish 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.

With the current studies the green Aggregator line is again set to close above 0 on Friday. This is highly unlikely to change. Meanwhile, the Differential Pivot will be 1,339.75.

This is about 3% above Thursday's close. This means that it would take a rally of at least this much in order to flip the Differential Line back to negative. Obviously this is a huge longshot. The implications are that a multi-day move higher is being suggested by the Aggregator.

I'm quite long at this point after aggressively increasing my index position on Thursday. I likely won't add on the last piece without a rise in the CBI or other very compelling evidence. There were a number of systems that triggered on the triggers spreadsheet tonight. Additionally, I noticed one Catapult for ETFs trade trigger. While the ETFs don't count towards the CBI, I decided I would look to take this one long. Details below.

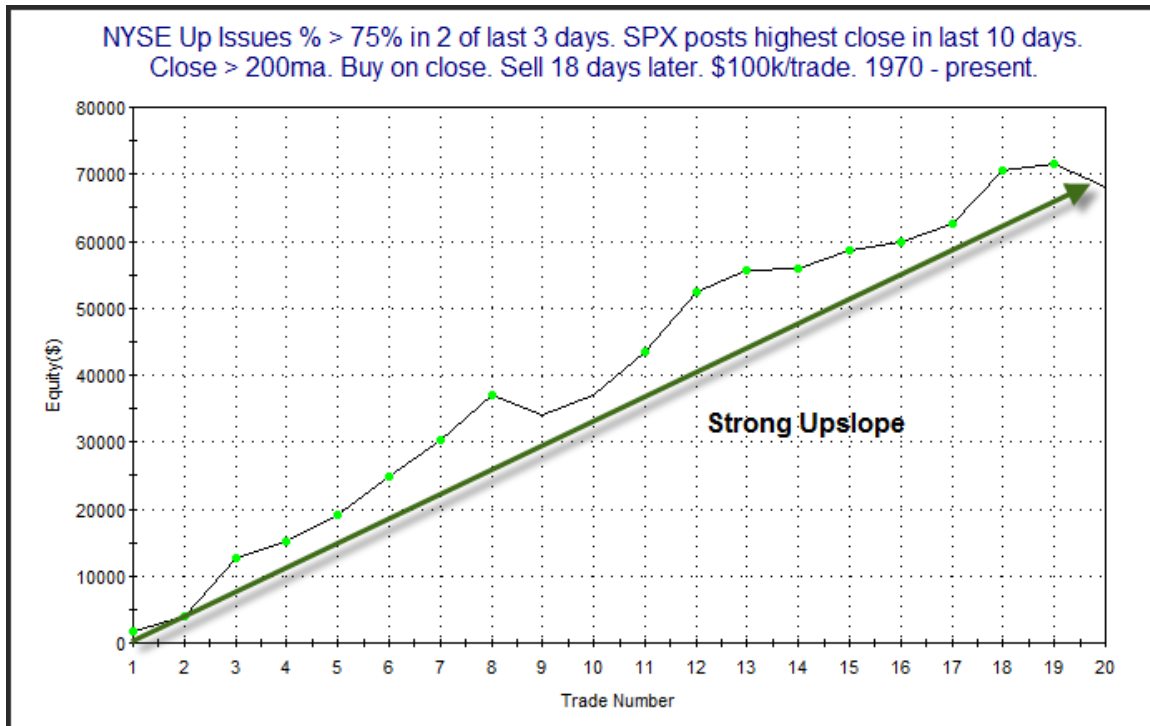
Intermediate-term Outlook (2 weeks – 2 months)– updated 7/25 – moderately bullish

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.

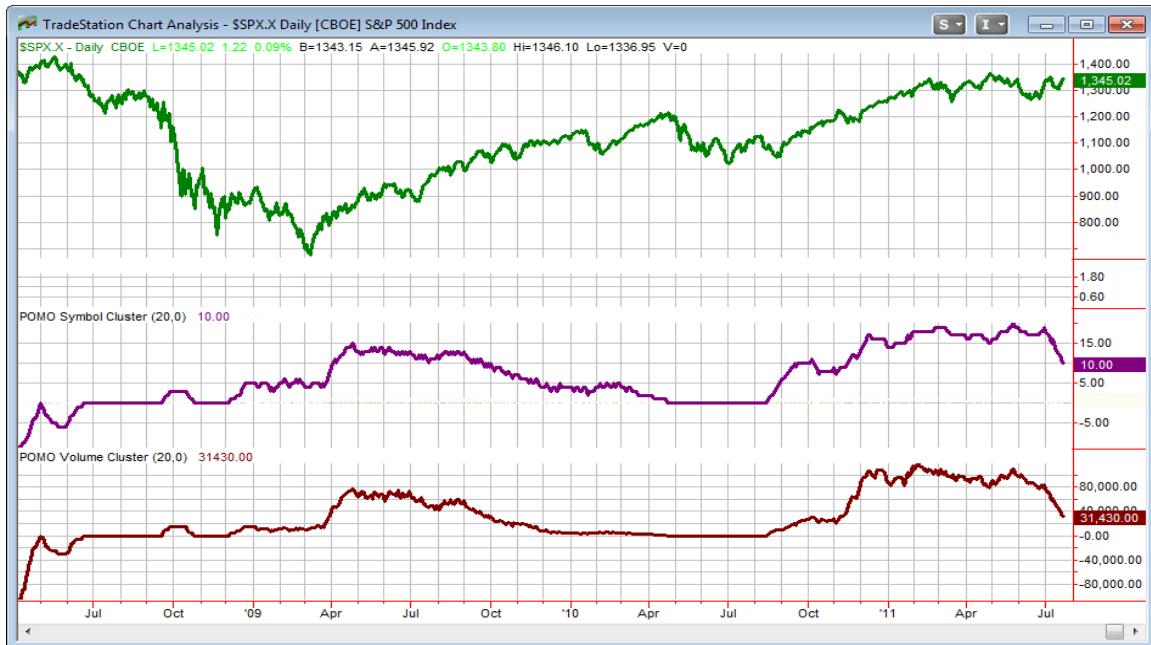


The strong upslope creates greater confidence in the upside edge.

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 3rd 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

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 3rd active intermediate-term breadth-thrust study. The other 2 were from March 22nd and July 5th. 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

FAA – buy @ \$30.49 limit.

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.

FAA – buy @ \$30.49 limit. Based on Catapult system and listed in the Catapult for ETF section above

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	7/26/2011	\$133.33	\$130.22	-2.33%		Aggregator
SPY(1/4)	7/28/2011	\$130.60	\$130.22	-0.29%		bought on open
SPY(1/4)	7/28/2011	\$130.22	\$130.22	0.00%		bought on close

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