

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 10, 2011

Volume 4 Issue 153

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- Too much to list. Mostly short-term bearish.

## *Short-term Outlook*

### *The Bottom Line*

Evidence is suggesting a 1-2 day pullback, but the net expectations over the next 3 days is still for upside. I'm still holding long but may start scaling out soon.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
August 10, 2011	VXO drops 20%	1-3 days	Bearish	
August 10, 2011	90% breadth from 50-day low	1 day	Bearish	
August 9, 2011	CBI >= 10	1-4 days	Bullish	
August 9, 2011	High Volume 100-day lows	1-3 days	Bullish	
August 4, 2011	1.75% drop.Next day big intraday bounce	1-5 days	Bullish	3.50%
<b>Active - Long Term</b>				
August 8, 2011	SPX Down 9 of 10 days and > 7.5%	1-20 days	Bullish	13.30%
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	
March 22, 2011	3 Days Up Issues % > 70%	8 months	Bullish	19.00%
October 25, 2010	SPX Golden Cross	int term	Bullish	
<b>Dropped Tonight</b>				
August 9, 2011	5% drop	1 day	Bullish	
August 5, 2011	5 lower lows. Today is larges.	1-2 days	Bullish	
August 4, 2011	50 low yest. High volume rally 2day	1-4 days	Bullish	2.70%
July 29, 2011	4 lower lows. 20-day low. Close >200	1-8 days	Bullish	2.40%

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

**The Evidence**

A big bounce arrived on Tuesday after some wild back and forth movement. At the end of the day the SPX closed up 4.7%, the Nasdaq rose 5.3%, and the Russell 2000 gained 6.9%. Breadth was incredibly strong. It was the 1<sup>st</sup> occurrence I could find where the NYSE Up Issue % came in at the lowest level in over a year 1 day (Monday) and the highest level in over a year the next (Tuesday). The NYSE Up Issues % was 92% and the Up Volume % was near 97%. Total volume came in high but just under Monday's levels.

There are quite a number of indicators to discuss tonight. These include volume, breadth, Fed Day seasonality, the CBI and the VIX. Overall, the rebound was exceptionally strong. So strong in the end in fact that several studies suggested it might be short-term overdone already. Bounces can be tricky and this one appears to be especially tricky at the moment. So let's look at a few things.

Volume

Several studies in the Quantifinder looked at days following SPX gains of 3% or 4%. They found that when such days occurred on the highest volume in at least 5 days then the indications were bullish. But when volume wasn't the highest of the past week then indications were short-term bearish. My issues with these studies tonight are that 1)

volume only missed Monday's extremely high level by a narrow margin and 2) it did so even with very quiet trading mid-day as participants awaited the Fed announcement. Below are a few studies that examine this concept and consider the fact that we are coming off intermediate-term lows. Because of my issues with the volume I am not including these on the active list, but subscribers are certainly free to disagree with me and incorporate these studies into their thinking. First with high volume:

**After closing at a 50-day low yesterday, SPX rises > 3% on the highest NYSE volume in 5 days. 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
10	43,297.49	11	8	3	72.73	6,502.42	-2,907.30	2.24	5.96	3,936.14
9	48,156.56	11	8	3	72.73	6,597.32	-1,540.67	4.28	11.42	4,377.87
8	33,860.56	11	9	2	81.82	4,243.87	-2,167.12	1.96	8.81	3,078.23
7	34,447.04	11	10	1	90.91	4,265.44	-8,207.38	0.52	5.20	3,131.55
6	31,119.56	11	8	3	72.73	4,460.92	-1,522.61	2.93	7.81	2,829.05
5	30,814.96	11	10	1	90.91	3,235.10	-1,536.08	2.11	21.06	2,801.36
4	28,062.52	11	8	3	72.73	4,614.52	-2,951.22	1.56	4.17	2,551.14
3	29,523.09	11	6	5	54.55	6,263.22	-1,611.25	3.89	4.66	2,683.92
2	14,999.57	11	6	5	54.55	3,673.27	-1,408.01	2.61	3.13	1,363.60
1	20,827.54	11	6	5	54.55	4,064.51	-711.91	5.71	6.85	1,893.41

And now without new high volume:

**After closing at a 50-day low yesterday, SPX rises > 3% today. NYSE volume is NOT the highest in 5 days. Buy SPX 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
10	-32,406.38	10	3	7	30.00	4,699.85	-6,643.70	0.71	0.30	-3,240.64
9	-48,073.90	11	2	9	18.18	7,758.43	-7,065.64	1.10	0.24	-4,370.35
8	-54,598.83	11	2	9	18.18	7,004.80	-7,623.16	0.92	0.20	-4,963.53
7	-50,471.19	11	3	8	27.27	4,004.52	-7,810.60	0.51	0.19	-4,588.29
6	-32,582.95	11	4	7	36.36	2,506.67	-6,087.09	0.41	0.24	-2,962.09
5	-22,612.47	11	4	7	36.36	3,696.34	-5,342.55	0.69	0.40	-2,055.68
4	-22,256.00	11	4	7	36.36	2,198.05	-4,435.46	0.50	0.28	-2,023.27
3	-19,010.45	12	3	9	25.00	1,982.56	-2,773.13	0.71	0.24	-1,584.20
2	-26,643.06	12	3	9	25.00	940.58	-3,273.87	0.29	0.10	-2,220.25
1	-8,547.61	12	3	9	25.00	562.22	-1,137.14	0.49	0.16	-712.30

Results here are polar opposites. As I mentioned, since I view volume today as tricky I'm inclined to ignore these results and just consider some of the other studies from tonight.

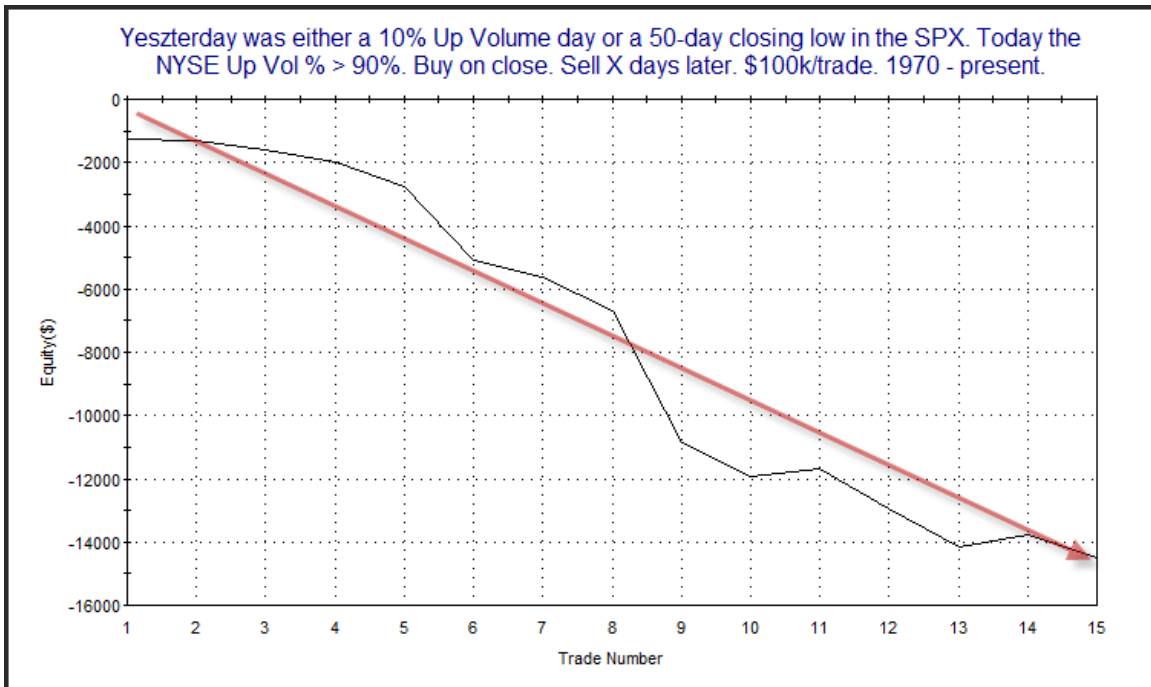
## Breadth

Breadth was also extreme as the NYSE put in the most lopsided day in over a year. Past studies have found that lopsided breadth following either new lows or extreme down days the day before has often been followed by a short-term pullback. The study below was last seen in the 5/24/10 subscriber letter. Results are updated.

Yesterday was either a 10% Up Volume day or a 50-day closing low in the SPX. Today the NYSE Up Vol % > 90%. 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
10	-20,665.17	12	4	8	33.33	4,330.40	-4,748.35	0.91	0.46	-1,722.10
9	-23,492.75	12	4	8	33.33	4,436.23	-5,154.71	0.86	0.43	-1,957.73
8	-26,982.22	12	4	8	33.33	2,691.32	-4,718.44	0.57	0.29	-2,248.52
7	-25,983.56	14	4	10	28.57	3,361.41	-3,942.92	0.85	0.34	-1,855.97
6	-19,843.10	14	4	10	28.57	3,997.73	-3,583.40	1.12	0.45	-1,417.36
5	-18,674.42	14	6	8	42.86	3,477.61	-4,942.51	0.70	0.53	-1,333.89
4	-20,040.71	14	8	6	57.14	1,654.30	-5,545.86	0.30	0.40	-1,431.48
3	-15,436.34	15	5	10	33.33	2,463.81	-2,775.54	0.89	0.44	-1,029.09
2	-22,849.11	15	5	10	33.33	1,494.02	-3,031.92	0.49	0.25	-1,523.27
1	-14,514.23	15	2	13	13.33	323.92	-1,166.31	0.28	0.04	-967.62

The stats seem to strongly favor a pullback, especially over the next 1-2 days. Below is an equity curve with a 1-day holding period.



Nothing wrong with this curve.

### VIX/VXO

The VIX and VXO also provided some clues on Tuesday as they fell hard from their perch. Both tumbled over 25% on Tuesday. The study below looks at drops greater than 20%. It was last seen in the 5/11/10 subscriber letter. Stats are updated.

<p style="text-align: center;">VXO closes down 20% today. Buy SPX on close. Sell 2 days later. \$100k/trade. 1987- present.</p>										
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	-30,672.52	16	3	13	18.75	2,656.36	-2,972.43	0.89	0.21	-1,917.03
4	-33,779.16	16	6	10	37.50	836.79	-3,879.99	0.22	0.13	-2,111.20
3	-30,245.66	16	4	12	25.00	878.54	-2,813.32	0.31	0.10	-1,890.35
2	-24,926.05	16	6	10	37.50	1,197.77	-3,211.27	0.37	0.22	-1,557.88
1	-9,460.08	16	2	14	12.50	1,730.67	-922.96	1.88	0.27	-591.26

Such sharp drops have almost always led to a down day in the SPX the next day. One concern I had was that the VXO was coming from such a high level. To see whether this might be a valid concern I ran some tests that looked at other instances where big drops in VXO still didn't wipe out the gains from the previous day.

<p style="text-align: center;">VXO closes down 15% today but closes above the close of 2 days ago. Buy SPX on close. Sell 2 days later. \$100k/trade. 1987- present.</p>				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
01/11/88	Buy	\$247.49	(0.68%)	\$711.04
01/13/88	Sell	\$245.80		(\$2,840.12)
11/18/91	Buy	\$385.23	(1.74%)	\$0.00
11/20/91	Sell	\$378.53		(\$2,678.06)
12/19/95	Buy	\$611.93	(0.24%)	\$381.42
12/21/95	Sell	\$610.49		(\$978.00)
03/11/96	Buy	\$640.02	(0.23%)	\$78.00
03/13/96	Sell	\$638.52		(\$1,747.20)
10/28/97	Buy	\$921.86	(1.97%)	\$1,445.04
10/30/97	Sell	\$903.69		(\$1,962.36)
02/28/07	Buy	\$1,406.82	(1.40%)	\$187.44
03/02/07	Sell	\$1,387.17		(\$1,842.45)

Based on what I see it appears my concerns were unfounded.

### Fed Day Edges

Part of what seemed to spark the rally (after a brief dip) was the Fed announcement on Tuesday. I noted last night that Fed Days are historically bullish and the oversold setup going into this one suggested a stronger than usual edge. It obviously played out. Over time I have noticed that unless the reaction is the same as the long-term trend, then Fed-day reactions are often retraced in the days following. In other words, while the Fed often looks good for a day, they don't typically cause the market to immediately bottom. The study below examines other times the Fed Day showed a gain and the day before was a 50-day low close.

Yesterday SPX closed at a 50-day low. Today is a Fed Day and SPX closed higher. Buy on close. Sell X days later. \$100k/trade. 1982 - 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	-13,517.83	6	0	6	0.00	0.00	-2,252.97	0.00	0.00	-2,252.97
4	-7,682.66	6	1	5	16.67	471.77	-1,630.89	0.29	0.06	-1,280.44
3	-2,185.40	6	1	5	16.67	3,403.82	-1,117.84	3.04	0.61	-364.23
2	-2,632.40	6	3	3	50.00	664.33	-1,541.79	0.43	0.43	-438.73
1	-4,721.47	6	4	2	66.67	717.77	-3,796.27	0.19	0.38	-786.91

Instances are low but they are all negative 1 week later. Below I have listed them all using a 5-day exit.

Yesterday SPX closed at a 50-day low. Today is a Fed Day and SPX closed higher. Buy on close. Sell 5 days later. \$100k/trade. 1982 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
08/16/88	Buy	\$260.56	(1.33%)	\$842.60
08/23/88	Sell	\$257.09		(\$1,543.49)
03/31/92	Buy	\$403.68	(1.39%)	\$553.28
04/07/92	Sell	\$398.06		(\$1,412.84)
01/30/02	Buy	\$1,113.57	(2.70%)	\$1,480.96
02/06/02	Sell	\$1,083.51		(\$3,185.31)
03/16/04	Buy	\$1,110.70	(1.51%)	\$1,355.40
03/23/04	Sell	\$1,093.90		(\$1,908.90)
06/25/08	Buy	\$1,321.97	(4.57%)	\$0.00
07/02/08	Sell	\$1,261.53		(\$4,596.75)
09/16/08	Buy	\$1,213.57	(2.09%)	\$4,227.10
09/23/08	Sell	\$1,188.20		(\$6,565.74)

### Other

So there appears to be quite a bit suggesting this bounce won't persist over the next few days. But even though SPX gains were strong it didn't even manage to make up for the losses of the previous day. The study below looked at instances just like this.

After closing at a 100-day low yest. the SPX rises over 4% today. It still closes < the close of 2 days ago. Buy on close. Sell next day's close. \$100k/trade. 1960 - now.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
10/20/87	Buy	\$236.83	9.10%	\$9,465.46
10/21/87	Sell	\$258.37		\$0.00
09/18/08	Buy	\$1,206.51	4.03%	\$4,806.02
09/19/08	Sell	\$1,255.08		\$0.00
09/30/08	Buy	\$1,166.36	(0.45%)	\$56.95
10/01/08	Sell	\$1,161.06		(\$2,175.15)
11/21/08	Buy	\$800.03	6.47%	\$8,130.68
11/24/08	Sell	\$851.81		\$0.00

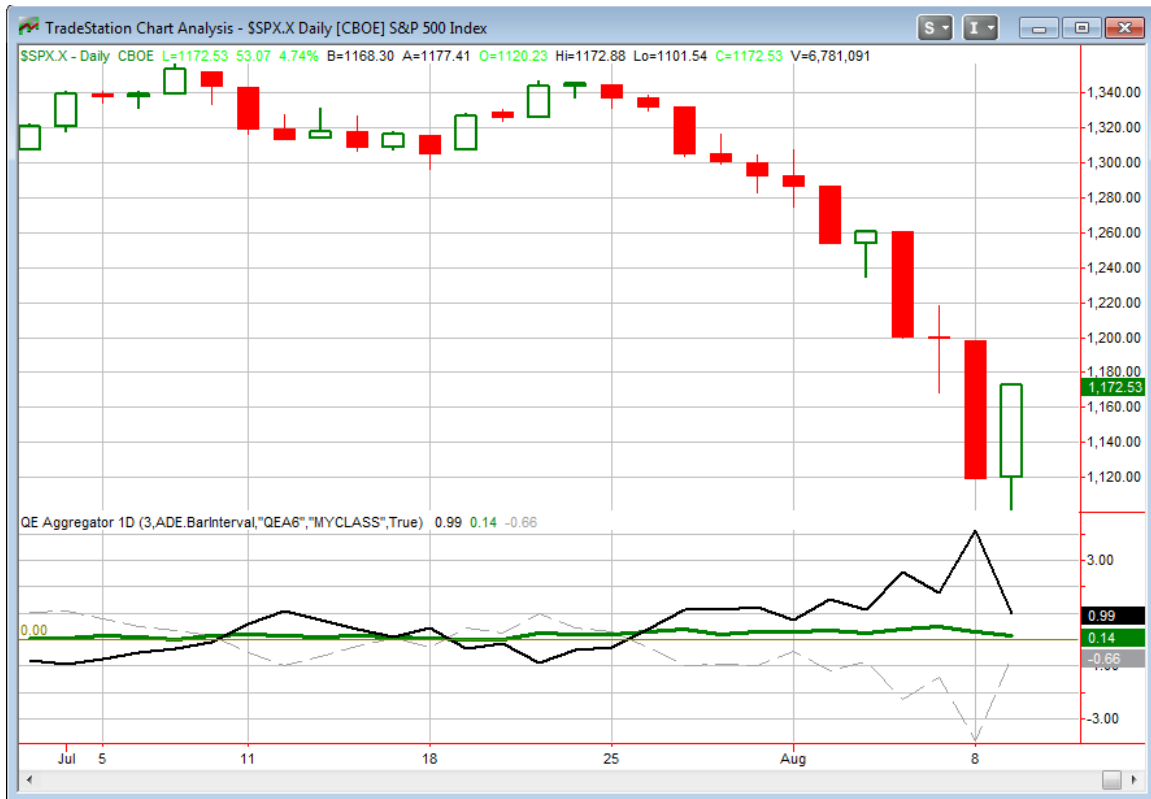
Instances are very low but as you can see the 1-day gains in the 3 winners were huge. It also appears the winners were all unfilled gaps up since drawdown was 0. Both this and the Fed Day study showed very low instances. Rather than try and generate estimates on such low occurrences I have simply chosen not to include either.

I also am always wary about downside inclinations when the CBI is elevated. The study below looks at other instances where the SPX posted very strong gains but the CBI still remained  $\geq 10$ .

SPX closes up 3% but CBI is still $\geq 10$ . Buy on close. Sell X days later. \$100k/trade. 1995 - 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	24,057.83	7	5	2	71.43	6,950.94	-5,348.43	1.30	3.25	3,436.83
19	27,953.18	7	5	2	71.43	7,552.02	-4,903.47	1.54	3.85	3,993.31
18	28,275.37	7	5	2	71.43	7,803.14	-5,370.17	1.45	3.63	4,039.34
17	33,381.17	7	5	2	71.43	7,817.22	-2,852.46	2.74	6.85	4,768.74
16	43,234.97	7	7	0	100.00	6,176.42	0.00	100.00	100.00	6,176.42
15	34,390.15	7	6	1	85.71	6,343.02	-3,667.95	1.73	10.38	4,912.88
14	28,421.94	7	6	1	85.71	5,307.89	-3,425.40	1.55	9.30	4,060.28
13	24,829.88	7	6	1	85.71	4,951.10	-4,876.74	1.02	6.09	3,547.13
12	23,692.84	7	5	2	71.43	6,270.72	-3,830.37	1.64	4.09	3,384.69
11	19,001.74	7	5	2	71.43	5,286.32	-3,714.93	1.42	3.56	2,714.53
10	13,714.24	7	5	2	71.43	6,006.84	-8,159.99	0.74	1.84	1,959.18
9	10,837.08	7	5	2	71.43	4,965.66	-6,995.61	0.71	1.77	1,548.15
8	3,157.64	7	4	3	57.14	4,472.91	-4,911.33	0.91	1.21	451.09
7	5,936.46	7	5	2	71.43	4,036.46	-7,122.92	0.57	1.42	848.07
6	3,073.68	7	3	4	42.86	5,217.99	-3,145.07	1.66	1.24	439.10
5	10,263.89	7	5	2	71.43	3,095.43	-2,606.63	1.19	2.97	1,466.27
4	16,023.20	7	4	3	57.14	6,391.21	-3,180.55	2.01	2.68	2,289.03
3	8,393.20	8	3	4	37.50	6,307.33	-2,632.20	2.40	1.80	1,049.15
2	-1,284.46	8	4	4	50.00	3,167.57	-3,488.69	0.91	0.91	-160.56
1	3,092.84	8	2	6	25.00	3,646.95	-700.18	5.21	1.74	386.61

The first few days appear to be a bit of a tossup. When you look out a little ways it seems the market typically works its way higher to eliminate the oversold condition.

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



Today's bearish studies brought the green Aggregator down much lower tonight though it still remains a little above 0. Levels above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the Differential Line also dropped but remained 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 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 in place the green Aggregator line is again set to close above 0 on Wednesday. This could change should additional bearish evidence emerge. Meanwhile, the Differential Pivot will be 1,208.57. This about 3% above Tuesday's close.

Evidence supporting the bearish case appears to be fairly strong tonight, but still not quite enough to flip the Aggregator. Also, with the market coming off such an oversold level, it hasn't really managed to revert to any mean yet. It's still even well below its 5ma. And of the 13 Catapult triggers that are active, 0 have hit their exit trigger so far. Shorting strong moves off of long-term lows is a dangerous practice even AFTER a

reversion has been achieved. The 1-day estimates are actually for downside, but flipping to the short side now based on tonight's studies would be a VERY aggressive play. I still think we have a ways to go on this bounce so that mean reversion can be achieved. Follow through may not be immediate, though. I will keep a close eye on what studies are appearing on Wednesday. Should the market manage to post more gains I may consider exiting some at the close. I will send out an intraday update if that is the case.

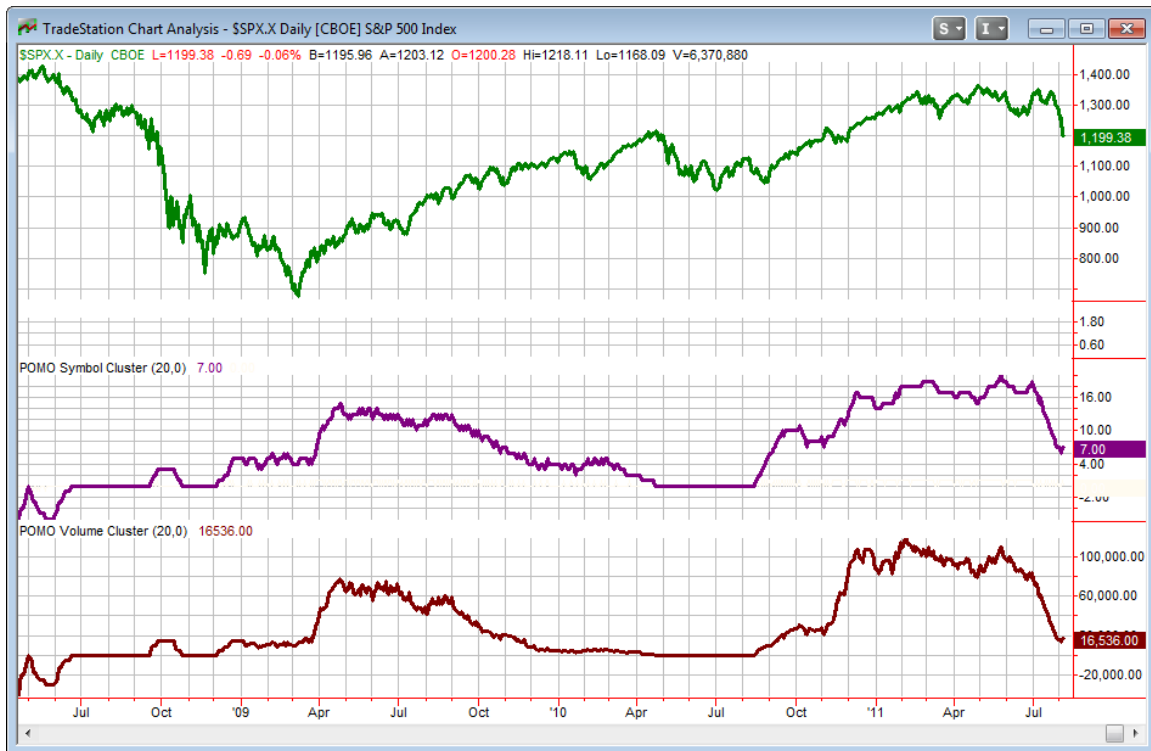
***Intermediate-term Outlook (2 weeks – 2 months)– updated 8/8 – neutral***

The market got hammered this week. From high to low it dropped over 13% in the last 2 weeks. We've seen a few intermediate-term studies either expire or be turned off. It also appears the "9/10 down days and 7.5% drop" study from the short-term outlook suggests bullish implication over the next month.

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>



POMO indicators barely budged this past week as they now seem to be settling in at their new (and ineffective?) levels. We should hear quite a bit from the Fed this week with the Fed meeting taking place and the next POMO schedule to be released on the 10<sup>th</sup>. The link below shows the current schedule but it will also work if you want to view the new schedule after 2pm on Wednesday.

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

So we are short-term oversold, and there is still some evidence suggesting bullish implications. The trend is clearly down now and this will increase risk for long-side trades. Also, the light amount of POMO buying that has been occurring doesn't seem to be providing much help to the market. I've changed my outlook to intermediate-term neutral. This means I will approach both long and short trades with some caution.

## **Catapult and Capitulative Breadth Statistics**

*Catapult & CBI Presentation Link*

### **Open Catapult Triggers**

WAG – 1/3 @ \$37.05

WAG – 1/3 @ \$37.03

BAC – 1/3 @ \$8.17

WAG – 1/3 @ \$35.22 (final lot)

ALL – 1/3 @ \$24.57

BAC – 1/3 @ \$6.51 (2<sup>nd</sup> lot) *not filled*

BAX – 1/3 @ \$50.31

COF – 1/3 @ \$37.63

EXC – 1/3 @ \$39.94

F – 1/3 @ \$9.93 *not filled*

HON – 1/3 @ \$44.29

RTN – 1/3 @ \$39.41

TXN – 1/3 @ \$26.19

### **Catapult for ETF's Trades**

*None.*

**Broad Market Large Cap CBI – 13 (WAG-3, BAC-2, ALL, BAX, COF, EXC, F, HON, RTN, TXN)**

### **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.*

## **Current Open Trade Ideas**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Price</b>	<b>% Gain/Loss</b>	<b>Stop</b>	<b>Notes</b>
SPY(1/4)	7/26/2011	\$133.33	\$117.46	-11.90%		Aggregator
SPY(1/4)	7/28/2011	\$130.60	\$117.46	-10.06%		Aggregator
SPY(1/4)	7/28/2011	\$130.22	\$117.46	-9.80%		Aggregator
PG	8/1/2011	\$61.43	\$60.32	-1.81%		system 80509
SPY(1/4)	8/3/2011	\$125.49	\$117.46	-6.40%		Aggregator
WAG(1/3)	8/5/2011	\$37.05	\$36.26	-2.13%		Catapult
XIV	8/5/2011	\$12.50	\$10.71	-14.32%		VIX System
WAG(1/3)	8/8/2011	\$36.00	\$36.26	0.72%		Catapult
BAC(1/3)	8/8/2011	\$7.40	\$7.60	2.70%		Catapult
WAG(1/3)	8/9/2011	\$35.22	\$36.26	2.95%		Catapult
ALL(1/3)	8/9/2011	\$24.57	\$25.75	4.80%		Catapult
EXC(1/3)	8/9/2011	\$39.94	\$41.39	3.63%		Catapult
HON(1/3)	8/9/2011	\$44.29	\$46.80	5.67%		Catapult
RTN(1/3)	8/9/2011	\$39.41	\$41.17	4.47%		Catapult
TXN(1/3)	8/9/2011	\$26.19	\$27.09	3.44%		Catapult
COF(1/3)	8/9/2011	\$37.63	\$40.82	8.48%		Catapult
BAX(1/3)	8/9/2011	\$50.31	\$52.31	3.98%		Catapult

### **Tip of the Day**

Click on any chart on the charts page to see a longer-term version of that indicator.

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