

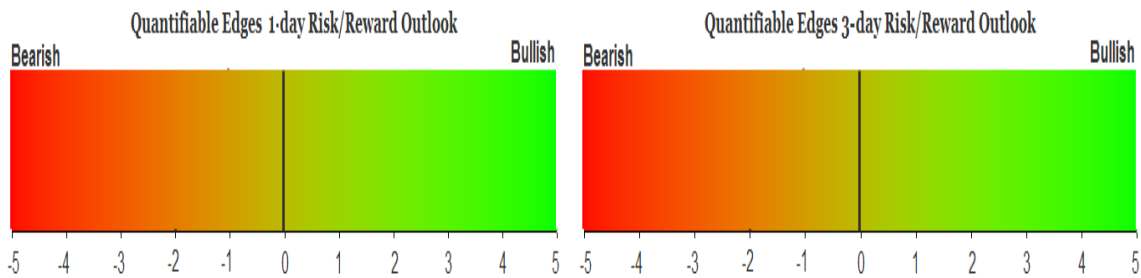
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 11, 2012

Volume 5 Issue 111

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Flat	50% Long XIV	Flat	Flat

Tonight's Research Points

- The steady, relatively slow decline in the VIX appears to be a good sign for a continuation of the rally over the next couple of days.
- POMO flows look strong this week..

Short-term Outlook

The Bottom Line

The Aggregator is neutral. The market is overbought but studies show it could still go higher. I'm flat and intend to stay that way until a more compelling setup emerges.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
June 11, 2012	VIX dn 5 days. Not stretched.	1-2 days	Bullish	
Active - Long Term				
June 7, 2012	90% up day on 3rd day of rally	1-14 days	Bullish	
May 21, 2012	CBI > 10.	1-20 days	Bullish	6.80%
February 1, 2012	Golden Cross	int term	Bullish	
December 5, 2011	POMO activity flat to negative	int term	Bearish	
Dropped Tonight				
June 5, 2012	Weak bounce after 1.75% drop	1-4 days	Bearish	

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

The Evidence

The first 15 minutes of trading saw the market selloff, but after that it was a steady move higher for the rest of the day on Friday. The major indices all posted solid gains. The SPX rose 0.8%, the Nasdaq rallied 1.0% and the Russell 2000 gained 1.2%. Breadth was solidly positive as the NYSE Up Issues % came in at 69% and the Up Volume % was 71%. Total NYSE volume was the lowest of the week.

I mentioned in the letter on Thursday night that one of the most dangerous times to try and short the market is when it is rallying from a long-term low. So despite the Aggregator showing a mild bearish inclination on Thursday, I stayed out of it. The first trading system I designed was in 2004. I designed the system to try and take advantage of overbought/oversold market conditions. I carefully studied reaction to overbought/oversold readings during different market regimes. The indicators I was using for the system did a nice job of anticipating reversals, but I found short signals were frequently run over during instances where the market was rallying from a long-term low. An adjustment I made in the system was that it would not take any short signals if the SPX had recently made a 100-day low. This simple adjustment improved results greatly. It is something I have remembered over the years, and have seen again and again where short-term overbought following a long-term low is a very risky short setup.

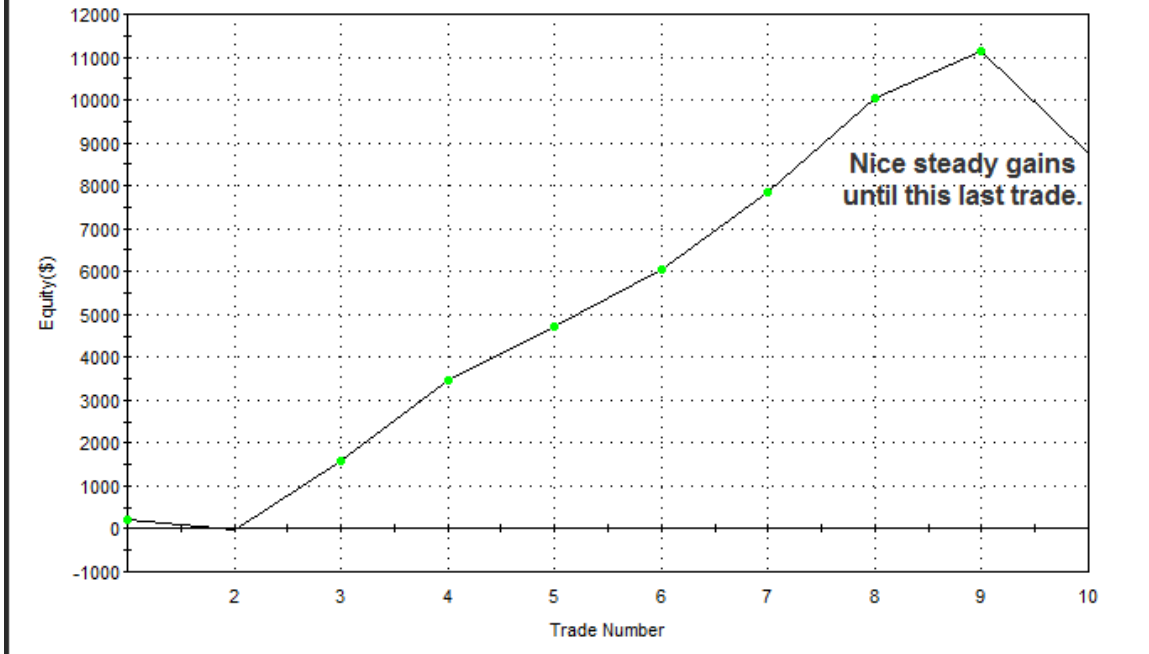
The Quantifinder did not come up with much on Friday. One observation I had that appeared encouraging is the fact that despite the strong move over the last five days, the VIX is not terribly oversold. The study below exemplifies why this is encouraging.

VIX down for 5th day in a row but is less than 10% below 10ma. SPX closed at 20-day low 5 days ago and is above 200ma today. Buy SPX 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: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	1,790.64	10	6	4	60.00	1,497.50	2,356.90	-1,798.59	-4,459.24	0.83	1.25	179.06
4	2,572.47	10	6	4	60.00	1,372.26	2,301.39	-1,415.28	-4,368.22	0.97	1.45	257.25
3	5,135.64	10	6	4	60.00	1,685.81	2,716.53	-1,244.81	-3,332.96	1.35	2.03	513.56
2	8,734.93	10	8	2	80.00	1,416.89	2,205.03	-1,300.09	-2,387.24	1.09	4.36	873.49
1	6,546.72	10	8	2	80.00	1,113.84	2,211.54	-1,182.00	-2,268.10	0.94	3.77	654.67

Instances are a bit low, making the study only mildly compelling, but the stats to this point suggest a possible upside edge. Below is a profit curve using a 2-day exit strategy.

VIX down for 5th day in a row but is less than 10% below 10ma. SPX closed at 20-day low 5 days ago and is above 200ma today. Buy SPX on close. Sell 2 days later. \$100k/trade. 1993 - present.



The last instance, which occurred on 5/31/11, was followed by a drop. Prior to that the setup had produced some nice steady gains. Though borderline, I decided it worth taking the study under consideration.

The Quantifinder did note that this upcoming week is options expiration week. Options expiration week has had a bullish tilt over the years. In the past I have broken down the performance by month. Unfortunately, the two months that did not show a bullish tilt were June and July. So from a seasonality standpoint, this week looks neutral.

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



The green Aggregator line is back in positive territory, and it would have been regardless of whether I elected to include the VIX study above. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line is still strongly below zero. This means the SPX is short-term overbought versus expectations. So net expectations are bullish but the SPX is overbought versus recent expectations. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. This meant the Aggregator System turned from short to flat. This was indicated as likely on the systems page near the close.

Unless bearish evidence rises on Monday, expectations will remain positive. Meanwhile, the Differential Pivot will be 1,316.13 on Monday. This means the SPX would need to close at or below that level in order to turn the Differential Line positive, signaling an oversold market. That would be a drop of 0.7%.

The Aggregator is neutral and I'm not seeing anything that is getting me interested in taking a position right now. Each day on the systems page, available to gold subscribers, I post a spreadsheet of S&P 500 stocks and ETFs that trigger any of the Quantifiable Edges numbered systems. Tonight is the first time in probably 2-3 months that not a single security has triggered any of the numbered systems. This further suggests to me that the

market is not in a high probability situation, and standing aside and awaiting the next opportunity is a reasonable approach for swing traders.

Intermediate-term Outlook (2 weeks – 2 months)– updated 6/11 – neutral

It was a strong week for the market, as the SPX closed up 3.7% over last week. We also had one study emerge with bullish intermediate-term implications. It appeared in the 6/7 letter. I have copied the excerpt from that letter below.

It looked at other times the SPX rose for at least 3 days in a row and the NYSE Up Volume % came in > 90%. It was last seen in the 3/14/12 letter. I have updated the results below.

SPX closes higher for at least the 3rd day in a row and NYSE Up Volume % > 90%. Buy on close. Sell X Days later. \$100k/trade. 10/20/87 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
20	38,410.14	19	12	7	63.16	4,693.29	14,074.06	-2,558.48	-5,866.30	1.83	3.14	2,021.59
19	28,055.41	19	13	6	68.42	3,635.90	9,897.86	-3,201.89	-7,086.20	1.14	2.46	1,476.60
18	31,709.11	19	14	5	73.68	3,385.97	8,619.73	-3,138.90	-4,913.70	1.08	3.02	1,668.90
17	41,204.74	19	14	5	73.68	3,814.23	11,270.42	-2,438.89	-5,553.90	1.56	4.38	2,168.67
16	45,447.57	19	15	4	78.95	3,627.16	12,204.08	-2,239.97	-6,770.50	1.62	6.07	2,391.98
15	44,306.45	20	14	6	70.00	3,958.79	11,124.12	-1,852.76	-5,239.30	2.14	4.99	2,215.32
14	43,251.30	20	17	3	85.00	2,860.19	8,025.22	-1,790.62	-2,533.16	1.60	9.05	2,162.57
13	31,610.91	21	16	5	76.19	2,448.31	7,484.65	-1,512.40	-3,373.70	1.62	5.18	1,505.28
12	30,429.03	21	16	5	76.19	2,421.42	7,583.70	-1,662.73	-2,355.10	1.46	4.66	1,449.00
11	27,557.95	21	13	8	61.90	2,675.96	8,671.60	-903.69	-2,496.80	2.96	4.81	1,312.28
10	27,581.55	21	15	6	71.43	2,626.33	10,921.96	-1,968.89	-2,811.20	1.33	3.33	1,313.41
9	25,365.14	21	15	6	71.43	2,310.21	8,397.62	-1,547.99	-2,298.27	1.49	3.73	1,207.86
8	20,068.45	21	15	6	71.43	2,204.13	7,394.80	-2,165.58	-3,753.26	1.02	2.54	955.64
7	24,472.10	21	14	7	66.67	2,361.86	9,599.94	-1,227.71	-2,724.73	1.92	3.85	1,165.34
6	17,290.13	21	13	8	61.90	2,275.67	5,066.85	-1,536.70	-3,497.62	1.48	2.41	823.34
5	13,192.88	21	16	5	76.19	1,777.84	4,428.90	-3,050.52	-6,695.61	0.58	1.86	628.23
4	11,959.29	21	16	5	76.19	1,519.33	5,800.13	-2,470.00	-6,719.68	0.62	1.97	569.49
3	3,018.40	21	14	7	66.67	1,342.41	3,641.54	-2,253.63	-5,298.72	0.60	1.19	143.73
2	4,836.60	21	16	5	76.19	904.82	4,479.84	-1,928.11	-8,004.64	0.47	1.50	230.31
1	5,114.85	21	9	12	42.86	961.74	2,860.08	-295.07	-1,140.30	3.26	2.44	243.56

Results here all point north – especially when you look out 2-3 weeks. Below I have listed all 20 instances with a 14-day holding period.

SPX closes higher for at least the 3rd day in a row and NYSE Up Volume % > 90%.
Buy on close. Sell 14 Days later. \$100k/trade. 10/20/87 - present.

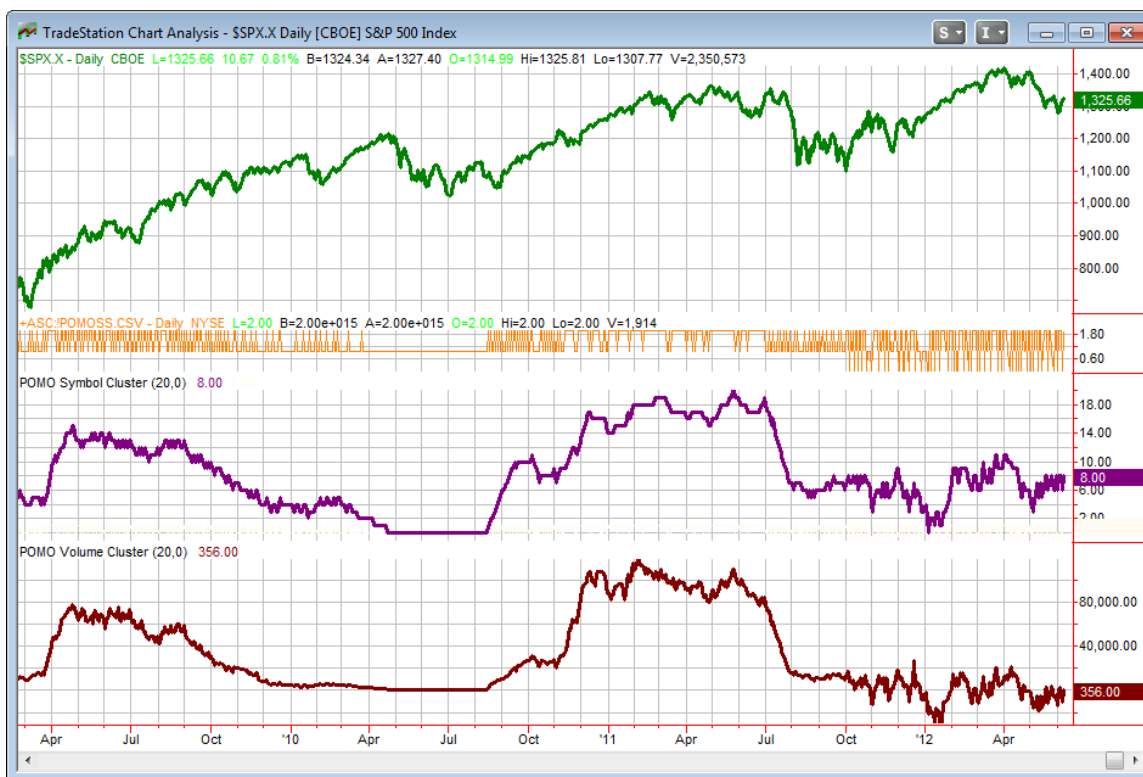
Date/Time	Signal	Price	% Profit	Run-up Drawdown
10/29/87	Buy	\$244.77	0.32%	\$5,071.44
11/18/87	Sell	\$245.55		(\$2,913.12)
05/12/89	Buy	\$313.84	3.72%	\$3,746.04
06/02/89	Sell	\$325.52		\$0.00
05/11/90	Buy	\$352.00	3.17%	\$3,271.68
06/01/90	Sell	\$363.15		(\$17.04)
01/02/03	Buy	\$909.03	(2.39%)	\$2,862.20
01/23/03	Sell	\$887.34		(\$3,535.40)
03/17/03	Buy	\$862.79	1.86%	\$3,807.65
04/04/03	Sell	\$878.85		(\$2,197.65)
03/21/07	Buy	\$1,435.04	0.27%	\$944.61
04/11/07	Sell	\$1,438.87		(\$1,803.66)
11/26/08	Buy	\$887.68	1.89%	\$3,491.04
12/17/08	Sell	\$904.42		(\$8,062.88)
03/12/09	Buy	\$750.74	8.04%	\$10,933.93
04/01/09	Sell	\$811.08		(\$1,101.24)
04/02/09	Buy	\$834.38	2.10%	\$4,908.75
04/23/09	Sell	\$851.92		(\$2,362.15)
07/15/09	Buy	\$932.68	7.82%	\$7,965.08
08/04/09	Sell	\$1,005.65		(\$559.61)
08/21/09	Buy	\$1,026.13	1.62%	\$2,138.85
09/11/09	Sell	\$1,042.73		(\$3,313.52)
11/09/09	Buy	\$1,093.08	0.23%	\$1,875.51
11/30/09	Sell	\$1,095.63		(\$849.94)
03/05/10	Buy	\$1,138.70	2.37%	\$3,653.13
03/25/10	Sell	\$1,165.73		(\$330.60)
07/13/10	Buy	\$1,095.34	2.79%	\$2,908.36
08/02/10	Sell	\$1,125.86		(\$3,499.86)
09/03/10	Buy	\$1,104.51	4.00%	\$3,995.10
09/24/10	Sell	\$1,148.67		(\$1,202.40)
07/01/11	Buy	\$1,339.67	0.40%	\$1,243.94
07/22/11	Sell	\$1,345.02		(\$3,237.50)
08/15/11	Buy	\$1,204.49	(2.53%)	\$2,176.26
09/02/11	Sell	\$1,173.97		(\$6,922.20)
10/06/11	Buy	\$1,164.97	6.61%	\$7,784.30
10/26/11	Sell	\$1,242.00		(\$1,250.35)
11/30/11	Buy	\$1,246.96	(0.45%)	\$1,608.00
12/20/11	Sell	\$1,241.30		(\$3,567.20)
03/13/12	Buy	\$1,395.96	1.64%	\$1,875.82
04/02/12	Sell	\$1,418.90		(\$645.39)

A couple of instances have faltered recently, but the upside edge still appears to be intact and the total gains are again hitting new highs. While the short-term inclinations are not terribly strong, I did include this study on the intermediate-term active list.

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 (purple) pane is the net rolling number of days in the last 20 that have been POMO days. In other words, a day the Fed buys on the market will add +1 while a day of selling will count as -1. The bottom pane is the total amount of money infused into (or taken out of) 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 4 days of POMO buying and 1 day of selling this past week. The net result was a \$4.8 billion liquidity infusion. This put the intermediate-term POMO indicators

back to neutral and near the middle of their recent range. Liquidity measures have been modest at best since the market topped out in early April.

This upcoming week is scheduled to see some nice inflows. The Fed is set to sell on Monday, but follow that up with buying Tuesday-Friday. The net inflows are anticipated to be just short of \$9 billion. This will put the QE Buying Power Index at "3" on Thursday and Friday. Also on Thursday and Friday the intermediate-term POMO volume indicator is expected to hit its highest level since mid-April. In other words, liquidity is relatively strong. If a rally is to emerge, we are entering a time period where POMO flows could help give a potential rally an extra boost.

I will again be on the lookout for an IBD Follow Through Day (FTD) this week. I have written an awful lot about FTDs on the blog over the years. Intermediate and short-term implications of FTDs are dependent on many different factors. A link to the FTD studies on the blog can be found below. If we get one in the next several days I will be sure to examine it closely and evaluate how it stands up historically.

<http://quantifiableedges.blogspot.com/search/label/IBD%20Follow%20Through%20Day>

Intermediate-term evidence remains mixed. I'm neutral at this point, readying to turn bullish. POMO flows may finally provide some help, we had a strong breadth signal this past week, and we are coming off a decline that triggered a CBI spike. I am going to be extra conservative with shorting since we are emerging from an intermediate-term low, and would prefer a pullback to buy into over the next few days. Still, I won't turn outright bullish until we see further evidence that the rally is likely to continue.

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.

None tonight.

Current Open Trade Ideas

None.

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 © 2012 Hanna Capital Management, LLC.