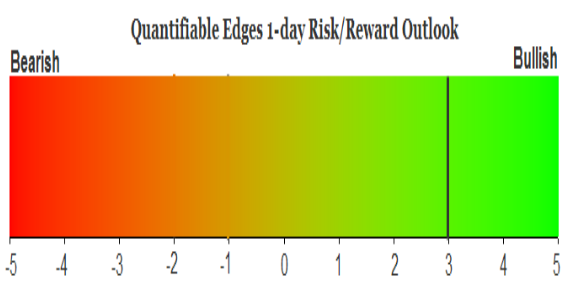
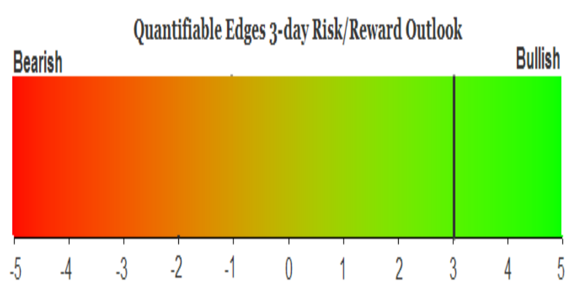
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 9, 2012 Volume 5 Issue 130

Market Overview





Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Long	100% Long XIV	Flat	Long

Tonight's Research Points

- The 8-day closing range is again overbought, suggesting a possible dip.
- Down closes on Employment Days have often led to a rebound the next day.

Short-term Outlook

The Bottom Line

Evidence is pointing higher and the SPX is now short-term oversold. I'm optimistic of a bounce in the next few days. I have a small amount of long exposure and I may add to it on Monday.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
July 9, 2012	Employment Day down. SPX > 200ma	1 day	Bullish	
July 9, 2012	8-day avg closing range > 75%	1-2 days	Bearish	-1.40%
July 5, 2012	75% Up Issues 2 of 3 & 10-high. > 200	1-6 days	Bullish	2.40%
June 29, 2012	SPY closes month at a high	1-5 days	Bullish	2.35%
Active - Long Term				
July 9, 2012	Nasdaq leading SPX	int term	Bullish	
June 18, 2012	POMO modestly bullish	int term	slight bull	
June 13, 2012	FTD with modest breadth & vol	int term	Bearish	
February 1, 2012	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.

Hanna Capital Management, LLC 16 Hillcrest Rd., Medfield, Massachusetts 02052 781-956-6952

The Evidence

Though it finished well off its lows, the market still had a pretty rough day on Friday. The SPX fell 0.9% while the NASDAQ and the Russell 2000 each lost 1.3%. Breadth was strongly negative as the NYSE Up Issues % came in at 33% and the Up Volume % was 18%. Aside from Tuesday's half-day, volume came in at the lowest level of 2012.

Much of Friday's big drop came courtesy of a disappointing employment number. This triggered the study below which examines SPX performance after weak Employment Days (during uptrends). It last appeared in the 5/7/12 letter and I have updated the stats.

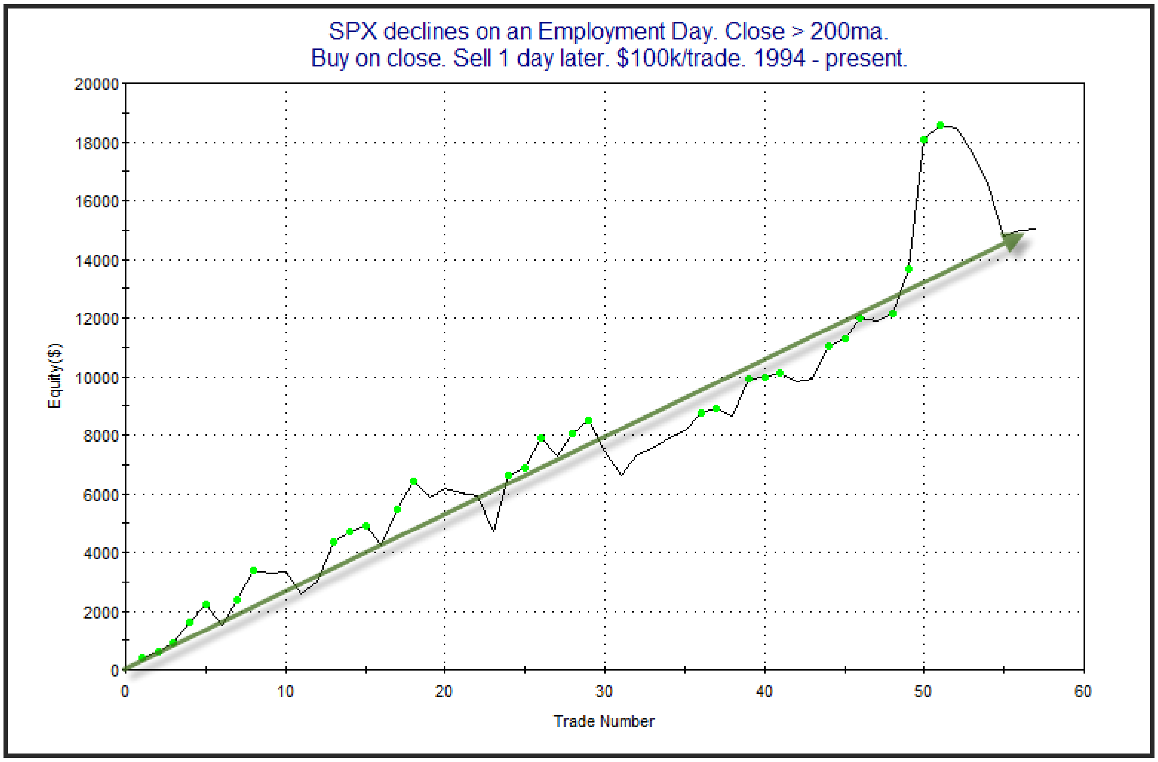
SPX declines on an Employment Day. Close > 200ma.
Buy on close. Sell 1 day later. $100k/trade. 1994 - present.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$15,034.14	Profit Factor	2.34
Gross Profit	$26,256.91	Gross Loss	($11,222.77)
Total Number of Trades	57	Percent Profitable	68.42%
Winning Trades	39	Losing Trades	18
Even Trades	0		
Avg. Trade Net Profit	$263.76	Ratio Avg. Win:Avg. Loss	1.08
Avg. Winning Trade	$673.25	Avg. Losing Trade	($623.49)
Largest Winning Trade	$4,396.50	Largest Losing Trade	($1,798.94)

The stats here are quite strong and all point to an upside edge. Below is a profit curve that shows how the possible edge has played out over time.



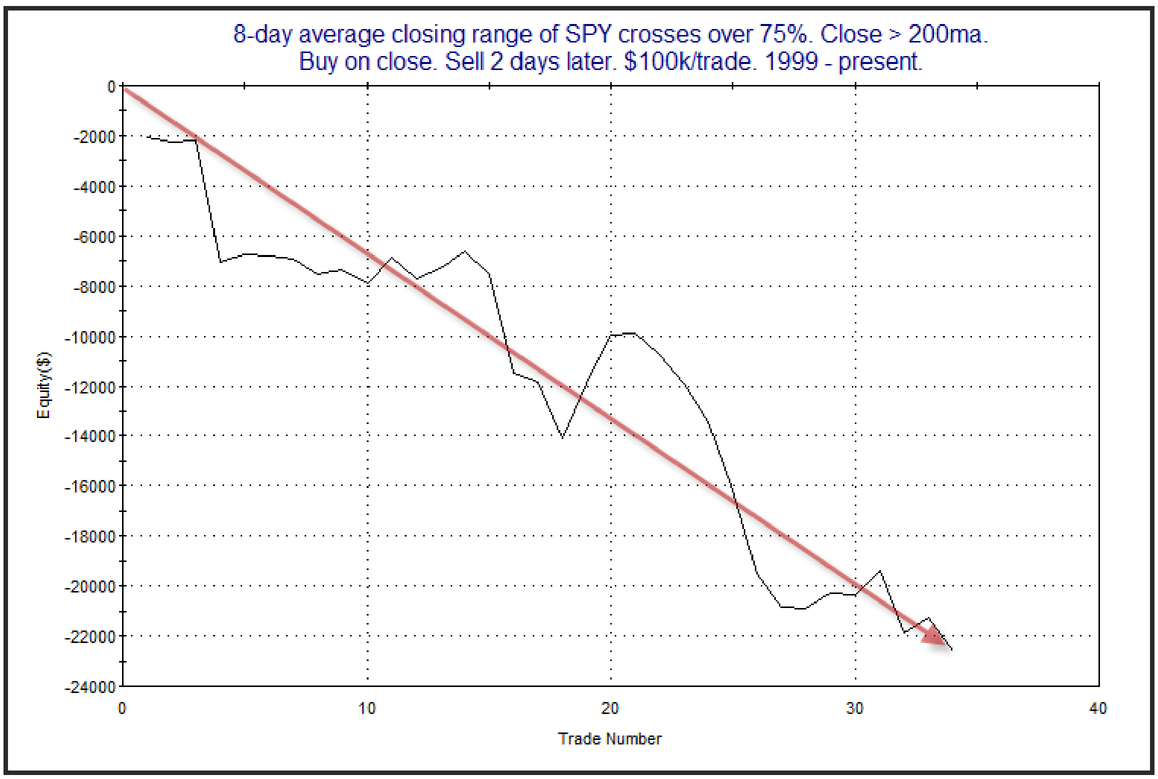
There were 4 instances in 2011 and they all closed lower. The January and May 2012 instances showed more typical gains. With a sample size this large the rough 2011 doesn’t mean the edge has run its course. In fact, the profit curve in now back to its long-term trendline. Of course it will be important to monitor going forward, but I still think a bullish edge exists.

Despite the losses on Friday, the market did manage to finish fairly close to its intraday highs. In Wednesday night’s letter I published a study that showed consistent closes near the high of the day, which can be a sign of optimism, will often lead to a short-term pullback. Friday's strong finish put the measure of optimism used in that study back into excessive territory, triggering the study all over again. So I reran the study and updated all of the statistics.

8-day average closing range of SPY crosses over 75%. Close > 200ma.
Buy on close. Sell X days later. $100k/trade. 1999 - 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	-23,200.84	29	14	15	48.28	949.66	2,426.72	-2,433.07	-4,637.61	0.39	0.36	-800.03
4	-19,087.76	29	13	16	44.83	997.68	2,907.88	-2,003.60	-4,807.86	0.50	0.40	-658.20
3	-18,988.07	30	12	18	40.00	833.67	2,604.54	-1,610.67	-3,618.23	0.52	0.35	-632.94
2	-22,629.84	34	12	22	35.29	746.67	2,186.14	-1,435.90	-4,848.40	0.52	0.28	-665.58
1	-9,614.10	34	15	19	44.12	332.24	1,029.30	-768.30	-2,738.12	0.43	0.34	-282.77

While the downside edge appears to remain in place for a full week, most of the edge has been realized over the 1st 2 days. Below is an equity curve showing how the edge has played out using a 2-day exit strategy.



It hasn't been the most consistent edge but it has moved from upper left to lower right, and with Wednesday's instance now included it is again making new lows. Therefore I have kept it on the short-term active list. So we again have a mix of studies being added tonight.

I have updated the Aggregator chart below.

Not much change in the green Aggregator line as it remained positive. Readings above 0 mean net expectations from the Active List are for upside over the next few days. With Friday's strong move down the black Differential Line moved even higher and is now well above 0. This means the SPX is oversold versus expectations. So net expectations are bullish and the SPX is oversold versus recent expectations. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. This meant the Aggregator System remained long at the close. This was indicated as likely on the systems page before the bell.

Based on the current active studies, expectations are set to remain positive on Monday. Of course this could change if more bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,381.09 on Monday. This is nearly 2% above Friday's close. That's a big gain for the market to try and tackle in just one day. So it seems unlikely that we will see the Differential Line close below zero Monday. The more likely scenario is that we will need to see a multi-day rally or consolidation to wear off the oversold condition.

So the Aggregator is clearly suggesting an upside edge, and based on how oversold the market is we should have at least a couple of days where this edge will persist. I took some long exposure at the close on Friday, and will take some more on Monday if we see additional selling. I'm still not getting too aggressive here. Although evidence is pointing up, there simply isn't that much of it, and two of the three bullish studies on the short-term active list are scheduled to expire on Monday. After that the only compelling bullish evidence will be courtesy of Wednesday's breadth thrust study. So I'm taking it slow, but I do think there is a tradable upside opportunity here and am positioning to take advantage of it.

Intermediate-term Outlook (2 weeks – 2 months)– updated 7/9 – slightly bullish

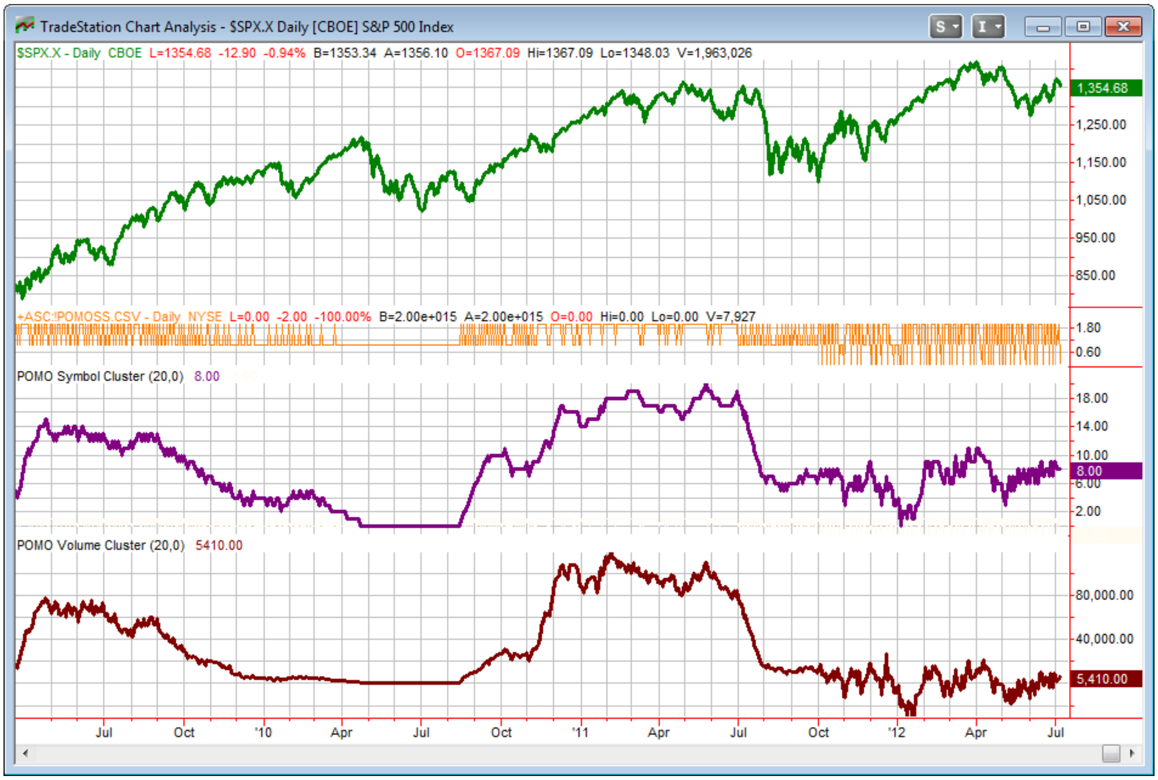
Two up days followed by two down days resulted in a mild loss for the week. The market bottomed four weeks ago, but the move off that bottom has been choppy and somewhat undecided. It appears to be struggling to establish a strong uptrend.

It seems nearly every week lately I've been talking about the SPX/NASDAQ relative strength indicator. The reason is that like the market, it keeps flipping back and forth. This week the NASDAQ was able to regain its leadership position, which is considered a bullish indication. Since the inception of the Nasdaq, the SPX has gained over 1,400 points when the Nasdaq was in leading position and has lost ground when the SPX is leading. The indicator has been less consistent over the last few years, but I would still prefer to see a leading Nasdaq. More information on the indicator may be found in this old blog post. Any subscriber who wants to download the model may do so on the Downloads page. The data in the Excel version has not been updated in a while, but the calculations are all there.

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 2 days of POMO buying and 1 day of selling this past week. But the size of the activity was skewed, and the net result was a moderate $1.4 billion liquidity withdrawal. This didn't have much effect on the intermediate-term POMO indicators. They remained positive and near the upper end of their 2 ½ month range.

This upcoming week we are again expected to see a large disparity between the size of the up days and the size of the down days. But there is buying scheduled on Monday, Tuesday, Wednesday, and Friday, and selling on Thursday. The net result should be close to a $2 billion liquidity inflow, which may be helpful for the market.

Intermediate-term evidence remains mixed but there appears to be a slight bullish tilt. Bullish evidence comes from POMO flows, momentum, and relative strength studies. FTD inclinations initially appeared bearish but the fact that the market has continued to move higher since the FTD is encouraging. I am still moderately favoring the bull case, but not yet ready to get aggressive.

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.

SPY – buy ¼ index position @ $135.25 LIMIT ON CLOSE. This is based on the short-term outlook above.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	7/6/2012	$135.49	$135.49	0.00%		bought on close

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