

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 1, 2011

Volume 4 Issue 63

Market Overview



Tonight's Research Points

- Positive seasonality will begin to kick in on Friday.
- Thursday's extremely narrow range on a down day suggests more short-term selling.
- The solidly positive Up Issues % on a down day for the SPX has commonly been followed by SPX gains.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook

The Bottom Line

Studies are mixed but favoring the bulls. Should the market sell off substantially Friday I will look start building a long position.

Summary of Recent Active Studies (see <http://QuantifiableEdges.blogspot.com> or Letters from listed dates for details)

Study Date	Description	Time span	Bias	Avg Max Move
Active				
April 1, 2011	Early April seasonally strong	1-4 days	Bullish	
April 1, 2011	SPX down. Up Issues % > 55%	1-3 days	Bullish	
April 1, 2011	Low range 60. SPX down. Close > 200	1-6 days	Bearish	-2.25%
March 30, 2011	Opposite 2-day gap and reverse in uptrd	1-3 days	Bearish	-1.20%
Active - Long Term				
March 22, 2011	3 Days Up Issues % > 70%	int term	Bullish	19.00%
November 22, 2010	High number of POMO Days recently	int term	Bullish	
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.

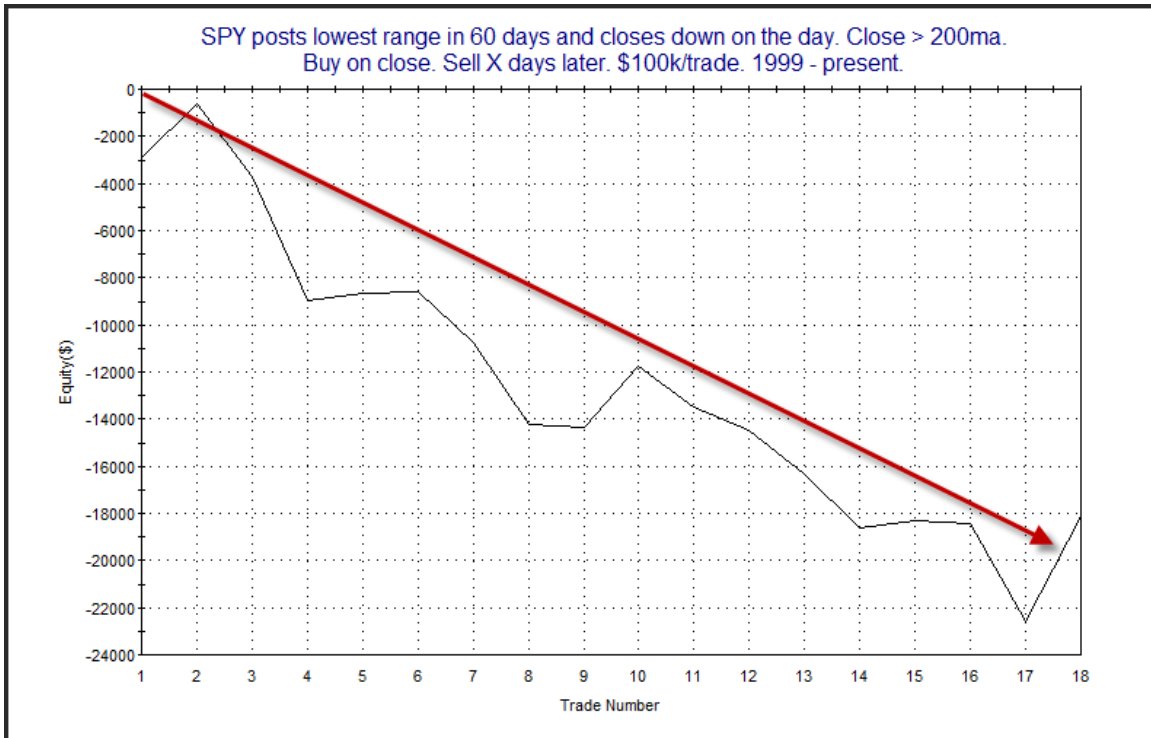
The Evidence

The market was open for business on Thursday but no one even noticed. It traded in the tightest range in a long time and saw the major indices finished mixed. The SPX closed down 0.2% while the Nasdaq rose 0.2% and the Russell 2000 tacked on 0.4%. Breadth was strangely mixed as well with the NYSE Up Issues % coming in at 58% and the Up Volume % at just 40%. Despite the inaction, total NYSE volume managed to rise for the 2nd day in a row.

Even though market action on Thursday appeared boring, a number of studies emerged that are worth discussing. Narrow range days and inside days are often followed by pullbacks when the market is in a long-term downtrend. But most of the studies that look at these low intensity days only look for mild extremes. There was one study that appeared in the Quantifinder tonight from the 5/12/09 Subscriber Letter. It required a 3-month low in the daily SPY range. Results suggested bearish implications but it was not broken out using a long-term trend filter. Tonight I added in a 200ma filter and updated the results.

SPY posts lowest range in 60 days and closes down on the day. 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: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	-9,980.60	17	8	9	47.06	1,403.93	-2,356.90	0.60	0.53	-587.09
9	-13,957.45	17	6	11	35.29	1,885.23	-2,297.17	0.82	0.45	-821.03
8	-15,865.13	18	7	11	38.89	1,522.17	-2,410.94	0.63	0.40	-881.40
7	-15,808.25	18	6	12	33.33	1,567.48	-2,101.09	0.75	0.37	-878.24
6	-18,093.87	18	6	12	33.33	1,670.02	-2,342.83	0.71	0.36	-1,005.22
5	-17,495.72	19	6	13	31.58	1,760.51	-2,158.37	0.82	0.38	-920.83
4	-14,548.97	19	5	14	26.32	1,900.61	-1,718.00	1.11	0.40	-765.74
3	-8,916.04	19	6	13	31.58	1,041.17	-1,166.39	0.89	0.41	-469.27
2	-3,790.56	19	12	7	63.16	591.71	-1,555.87	0.38	0.65	-199.50
1	-3,242.54	19	8	11	42.11	529.35	-679.76	0.78	0.57	-170.66

Such extremely low range on a day the SPY dips a little has commonly been followed by a further drop – even above the 200ma. Below is the equity curve which shows how this edge has played out over time using a 6-day exit strategy.



Despite the last trade that was sharply positive, the downslope is quite persistent. This serves as further confirmation of a short-term bearish edge.

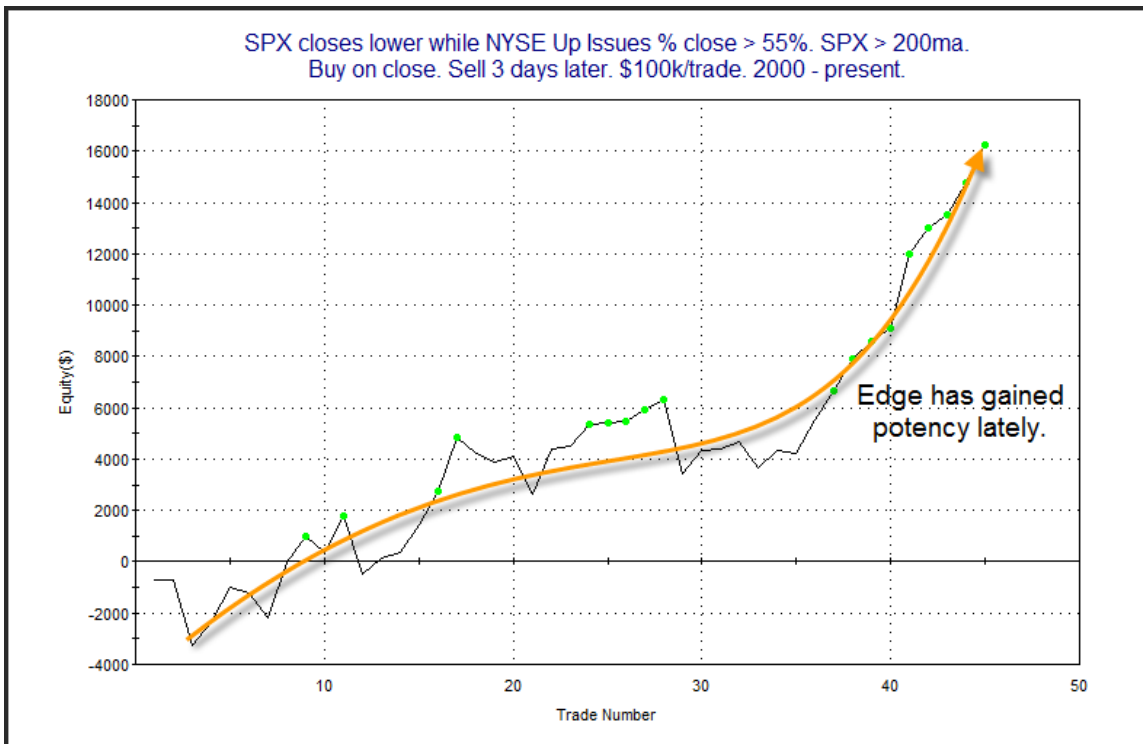
But not everything was pointing in one direction tonight. Studies were quite mixed. One study strongly suggesting a rise over the next few days is the early-April seasonality study that I showed last night. Another study that triggered tonight was last seen in the 1/3/11 Subscriber Letter. It examines occurrences of a negative SPX close on a day that the NYSE Up Issues % came in above 55%. I have updated that study below.

SPX closes lower while NYSE Up Issues % close > 55%. SPX > 200ma.
Buy on close. Sell X days later. \$100k/trade. 2000 - 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	16,299.21	43	27	16	62.79	1,416.91	-1,372.34	1.03	1.74	379.05
4	16,390.33	44	27	17	61.36	1,348.04	-1,176.87	1.15	1.82	372.51
3	16,263.54	45	32	13	71.11	941.59	-1,066.73	0.88	2.17	361.41
2	12,807.17	45	31	14	68.89	829.21	-921.31	0.90	1.99	284.60
1	9,563.39	47	28	19	59.57	677.89	-495.66	1.37	2.02	203.48

87% of instances posted a close above the entry price at some point in the next 4 days.

This isn't the strongest edge we've ever seen, but it does suggest at least a decent bullish tendency, and the consistency is pretty good. To make sure it was still worthy of inclusion among the active studies, I ran a 3-day equity curve. This is shown below.



While the curve certainly appears choppy, the slope has always been upwards, and recent results are stronger than ever. I believe this study is worth taking into consideration and including among the active studies.

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



Positive seasonality and breadth helped to move the green Aggregator line back above 0 tonight despite the bearish narrow range study I showed earlier. The positive value means the net expectation from the Active Studies List is for upside over the next few days. Meanwhile the black Differential line remains below 0. Readings below 0 mean the SPX has outperformed expectations over the last few days. So net expectations are for upside but the SPX is relatively overbought. This is considered a neutral configuration. A neutral configuration occurs whenever the green and black lines on the Aggregator chart fall on opposite sides of 0. Due to this the Aggregator System switched from short to flat at the close.

At this point the green Aggregator line is set to remain above 0 on Friday. This could change should additional bearish evidence emerge. Meanwhile, the Differential Pivot will be 1,316.09. This is about 0.75% below Thursday's close. So for the Differential line to move back above 0 the SPX will need to drop at least this much.

There were some fairly strong bearish inclinations during the past week and the market has managed to power through them. When the market manages to ignore bearish inclinations that can often be a bullish sign in itself. On top of that we now have positive expectations thanks to seasonality and breadth. The problem is that the SPX remains

strongly overbought even with Thursday's decline. The strongly overbought condition increases downside risk. I exited my short SPY positions as I indicated I would do in the intraday update sent to gold subscribers on Thursday. Should the market close below the Differential Pivot on Friday I will look to start building a long position. Details in the trade ideas section below.

Intermediate-term Outlook (2 weeks – 2 months)– updated 3/28 – bullish

We've seen some very choppy action in the market over the last month-plus. The rebound this past week has now put us a little above the midpoint of the five-week range. So the question for intermediate-term traders is whether this five-week range is going to break to the upside, allowing the rally to continue, or whether a downside break will create a new leg down.

There was one study that appeared this past week that would seem to strongly suggest a continuation of the uptrend. The 3-day upthrust from 3/17 - 3/21 that came off the 3/16 bottom was especially strong. Each of the three days saw the NYSE Up Issues % close at least 70%. A 3-day upthrust of this magnitude has been quite rare. The study below appeared in Monday night's subscriber letter and examines past instances.

NYSE Up Issues % > 70% for the 3rd day in a row. Buy SPX on close. Sell X days later. \$100k/trade. 1967 - 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
200	165,783.08	10	8	2	80.00	20,992.50	-1,078.46	19.47	77.86	16,578.31
190	179,921.56	10	10	0	100.00	17,992.16	0.00	100.00	100.00	17,992.16
180	189,510.43	10	10	0	100.00	18,951.04	0.00	100.00	100.00	18,951.04
170	193,444.26	12	12	0	100.00	16,120.36	0.00	100.00	100.00	16,120.36
160	190,654.61	12	12	0	100.00	15,887.88	0.00	100.00	100.00	15,887.88
150	189,374.16	12	12	0	100.00	15,781.18	0.00	100.00	100.00	15,781.18
140	174,839.17	12	12	0	100.00	14,569.93	0.00	100.00	100.00	14,569.93
130	155,443.52	13	12	1	92.31	13,423.27	-5,635.69	2.38	28.58	11,957.19
120	124,165.35	13	11	2	84.62	11,457.94	-936.02	12.24	67.33	9,551.18
110	114,709.32	13	13	0	100.00	8,823.79	0.00	100.00	100.00	8,823.79
100	108,917.44	13	11	2	84.62	10,146.31	-1,345.98	7.54	41.46	8,378.26
90	112,591.69	13	11	2	84.62	10,792.99	-3,065.58	3.52	19.36	8,660.90
80	106,199.39	13	12	1	92.31	9,368.54	-6,223.12	1.51	18.07	8,169.18
70	80,683.41	13	12	1	92.31	7,434.63	-8,532.18	0.87	10.46	6,206.42
60	82,174.40	14	12	2	85.71	8,170.87	-7,938.01	1.03	6.18	5,869.60
50	81,600.52	15	12	3	80.00	8,814.94	-8,059.59	1.09	4.37	5,440.03
40	56,862.16	15	12	3	80.00	7,577.48	-11,355.88	0.67	2.67	3,790.81
30	46,902.20	16	11	5	68.75	6,278.54	-4,432.34	1.42	3.12	2,931.39
20	55,292.65	16	13	3	81.25	5,463.75	-5,245.36	1.04	4.51	3,455.79
10	26,652.70	17	13	4	76.47	3,262.61	-3,940.32	0.83	2.69	1,567.81

The long-term consistency is quite amazing. The average trade appears quite large as well. I've listed below all 12 instances with a 170-day exit.

NYSE Up Issues % > 70% for the 3rd day in a row.
Buy SPX on close. Sell 170 days later. \$100k/trade. 1967 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
01/09/67	Buy	\$82.81	14.16%	\$15,715.14
09/11/67	Sell	\$94.54		\$0.00
05/29/70	Buy	\$76.55	25.25%	\$25,244.98
01/29/71	Sell	\$95.88		(\$6,947.92)
10/11/74	Buy	\$71.14	28.56%	\$30,558.75
06/16/75	Sell	\$91.46		(\$8,612.65)
01/05/76	Buy	\$92.58	12.66%	\$14,439.60
09/03/76	Sell	\$104.30		\$0.00
01/05/79	Buy	\$99.13	8.60%	\$10,785.60
09/07/79	Sell	\$107.66		(\$3,780.00)
08/18/82	Buy	\$108.52	48.09%	\$48,997.20
04/20/83	Sell	\$160.71		(\$1,077.57)
08/03/84	Buy	\$162.35	9.65%	\$13,277.85
04/08/85	Sell	\$178.02		(\$1,432.95)
12/26/91	Buy	\$404.84	2.15%	\$5,011.63
08/27/92	Sell	\$413.53		(\$3,072.68)
03/21/07	Buy	\$1,435.04	0.32%	\$9,732.45
11/20/07	Sell	\$1,439.70		(\$4,446.36)
01/02/09	Buy	\$931.80	9.08%	\$11,500.36
09/04/09	Sell	\$1,016.40		(\$28,356.07)
09/08/09	Buy	\$1,025.39	14.27%	\$18,857.77
05/12/10	Sell	\$1,171.67		(\$527.68)
07/09/10	Buy	\$1,077.95	21.00%	\$24,483.04
03/11/11	Sell	\$1,304.28		(\$3,519.00)

The average runup was 19% and the average drawdown was 5%.

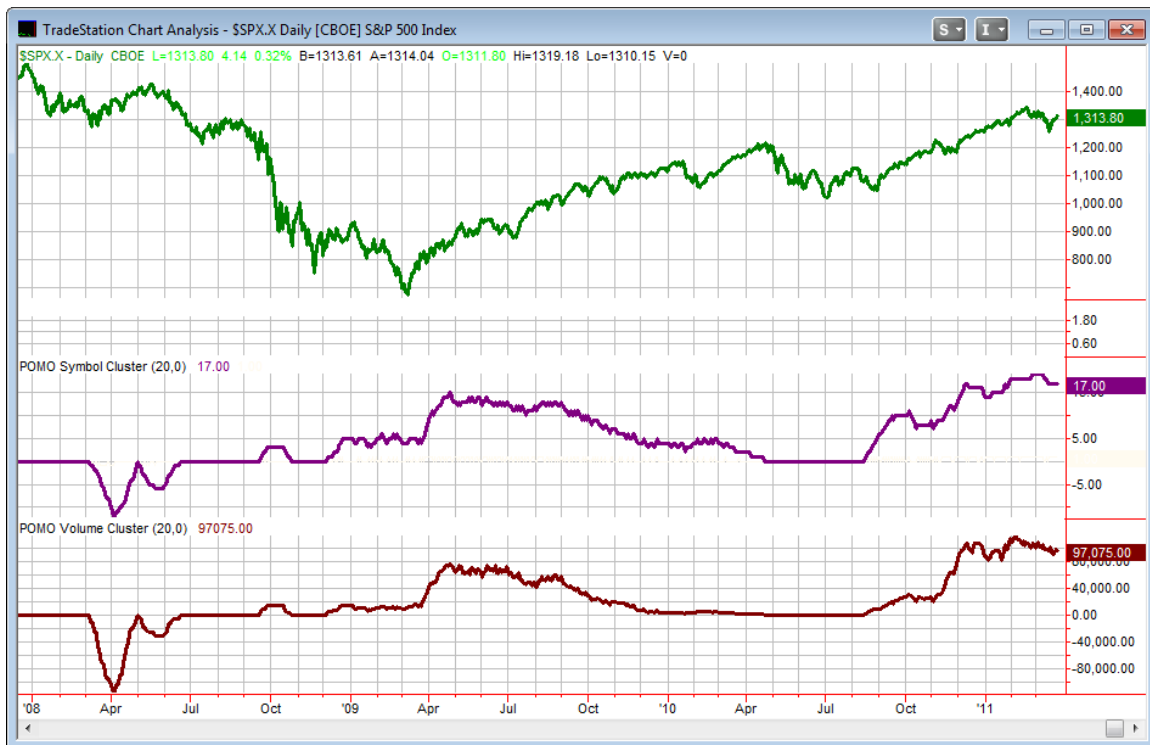
As you can see, 7 of the 12 made double-digit returns over the 170 days. The lowest runup of 5% is equal to the average drawdown, and 10 of 12 instances saw double digit runups during the 170-day periods. I have added this study to the intermediate-term active list.

The Fed's current POMO activity also remains a potential positive. 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>



The POMO Days indicator is still extremely elevated at 17. According to the tentative operations schedule we should see additional POMO buying Monday-Thursday of this upcoming week before an off-day on Friday. Both the POMO Days and POMO Volume indicators appear likely to remain bullish. I expect POMO to continue to provide a steady wind at the market's back. For those that would like to view the upcoming schedule I have provided a link below.

http://www.newyorkfed.org/markets/tot_operation_schedule.html

The market may still have some chopping around left to do, and the short-term outlook suggests a pullback here is likely. From a longer-term standpoint I'm still favoring the long side. The short-term pullback may be shallow or it may test the recent lows, but

ultimately I'm optimistic that the long-term uptrend still has a ways to go. For my own trading this means I will be more inclined to take bullish setups more aggressively and bearish setups more conservatively.

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 on SPX close of 1,316.09 or lower. Based on short-term outlook above.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	3/30/2011	\$132.55	\$132.59	-0.03%		covered on close

The Aggregator short signal finished a loser. I took a couple of stabs at the short side with this latest Aggregator signal. By staying small and agile (and being a bit lucky) I was able to manage a slight gain between the 2 entries rather than loss. The series of actions over the past week is a prime example of why I tend to be cautious with trades that go against my intermediate-term outlook.

Despite a scary dip and some trades that may have tested traders resolve, the trade ideas published in the letter showed some pretty good results in March. That makes the 6th month in a row that these raw results come in positive. Of course subscribers may pull the results spreadsheet down at any time. It is accessible from either the “Downloads” page or the “Systems” page.

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