

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 4, 2011

Volume 4 Issue 64

## Market Overview



## Tonight's Research Points

- 20-day SPY highs, an unfilled gap, and a close below the open have been followed by further gains in the past.
- 10 days above the 5ma and a new 10-day high suggest the market is due for a brief pullback,
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is flat.

## *Short-term Outlook*

### *The Bottom Line*

Studies remain mixed but favoring the bullish case. The market is a bit overdone to the upside though, leaving me neutral short-term.

*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
<b>Active</b>				
April 4, 2011	Unfilled gap. 20-day high. Close<open.	1-4 days	Bullish	1.40%
April 4, 2011	10 day > 5ma & a 10-day high.	1-2 days	Bearish	-1.20%
April 1, 2011	Early April seasonally strong	1-4 days	Bullish	
April 1, 2011	SPX down. Up Issues % > 55%	1-3 days	Bullish	1.20%
April 1, 2011	Low range 60. SPX down. Close >200	1-6 days	Bearish	-2.25%
<b>Active - Long Term</b>				
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	
<b>Dropped Tonight</b>				
March 30, 2011	Opposite 2-day gap and reverse in uptrd	1-3 days	Bearish	-1.20%

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

## *The Evidence*

A positive reaction to the employment report got the day off to a good start on Friday. The good times continued to roll until about noon. That's when the market hit its peak and began drifting sideways. Then a late afternoon selloff pushed the market down below its morning lows before stabilizing in the last half-hour. In the end gains were modest. The SPX rose 0.5%, the NASDAQ was up 0.3%, and the Russell 2000 tacked on 0.4%. Breadth was solidly positive as the NYSE Up Issues % came in at 68% and the Up Volume % was 74%. Total NYSE volume declined a bit from Thursday's levels, but SPY volume was up.

Some traders may have been disappointed by the relatively weak close. Late day reversals are sometimes interpreted as bearish. In fact, though the market took quite a dip from its highs of the day, it still never threatened its opening gap and traded in positive territory all day. Historically, unfilled gaps and 20-day intraday highs as was put in on Friday have been followed by much more positive action when the rally did not persist into the close. Friday's action appears bullish. This is something I last demonstrated in the December 30, 2010 Subscriber Letter. Below is an excerpt from that letter. I have updated all stats tables.

*I ran a test of performance following unfilled upside gaps that make a 20-day high. Below I've broken out the results by times the SPY closed above the open versus times where it closed below the open.*

*First let's look at those times where the finish was relatively strong:*

SPY posts a 20-day intraday high & a low > yesterday's close. It then closes ABOVE the open and > 200ma. Buy 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: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	3,615.91	104	54	48	51.92	1,780.30	-1,927.51	0.92	1.04	34.77
9	9,421.93	110	62	47	56.36	1,560.61	-1,858.21	0.84	1.11	85.65
8	-934.54	115	65	48	56.52	1,379.90	-1,888.09	0.73	0.99	-8.13
7	-1,113.67	119	68	49	57.14	1,230.42	-1,730.25	0.71	0.99	-9.36
6	5,993.31	124	62	61	50.00	1,136.09	-1,056.46	1.08	1.09	48.33
5	9,847.26	127	67	58	52.76	1,034.59	-1,025.34	1.01	1.17	77.54
4	12,691.48	140	79	60	56.43	971.39	-1,067.48	0.91	1.20	90.65
3	1,115.41	152	88	63	57.89	686.88	-941.75	0.73	1.02	7.34
2	-5,504.89	159	83	75	52.20	545.51	-677.10	0.81	0.89	-34.62
1	3,697.58	169	86	82	50.89	423.08	-398.62	1.06	1.11	21.88

There doesn't appear to be any edge in either direction here. Now let's examine times like the present where SPY closed below the open.

**SPY posts a 20-day intraday high & a low > yesterday's close. It then closes < the open but > 200ma. Buy 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: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	26,406.71	26	16	10	61.54	2,527.53	-1,403.37	1.80	2.88	1,015.64
9	20,458.59	26	19	7	73.08	1,776.16	-1,898.36	0.94	2.54	786.87
8	18,302.98	26	18	7	69.23	1,792.33	-1,994.13	0.90	2.31	703.96
7	17,530.69	26	16	10	61.54	1,946.72	-1,361.68	1.43	2.29	674.26
6	17,910.65	26	17	9	65.38	1,856.99	-1,517.57	1.22	2.31	688.87
5	14,844.39	26	15	11	57.69	1,666.64	-923.21	1.81	2.46	570.94
4	14,935.26	26	18	8	69.23	1,182.74	-794.26	1.49	3.35	574.43
3	18,070.65	28	20	7	71.43	1,146.39	-693.89	1.65	4.72	645.38
2	11,721.79	29	17	12	58.62	1,065.88	-533.18	2.00	2.83	404.20
1	4,579.22	30	18	12	60.00	548.00	-440.39	1.24	1.87	152.64

**26 of 30 instances (87%) posted a close above the entry price at some point in the next 3 days.**

These results are substantially better than earlier where the finish was good. Rather than worrying about the weak finish bulls should be excited by it.

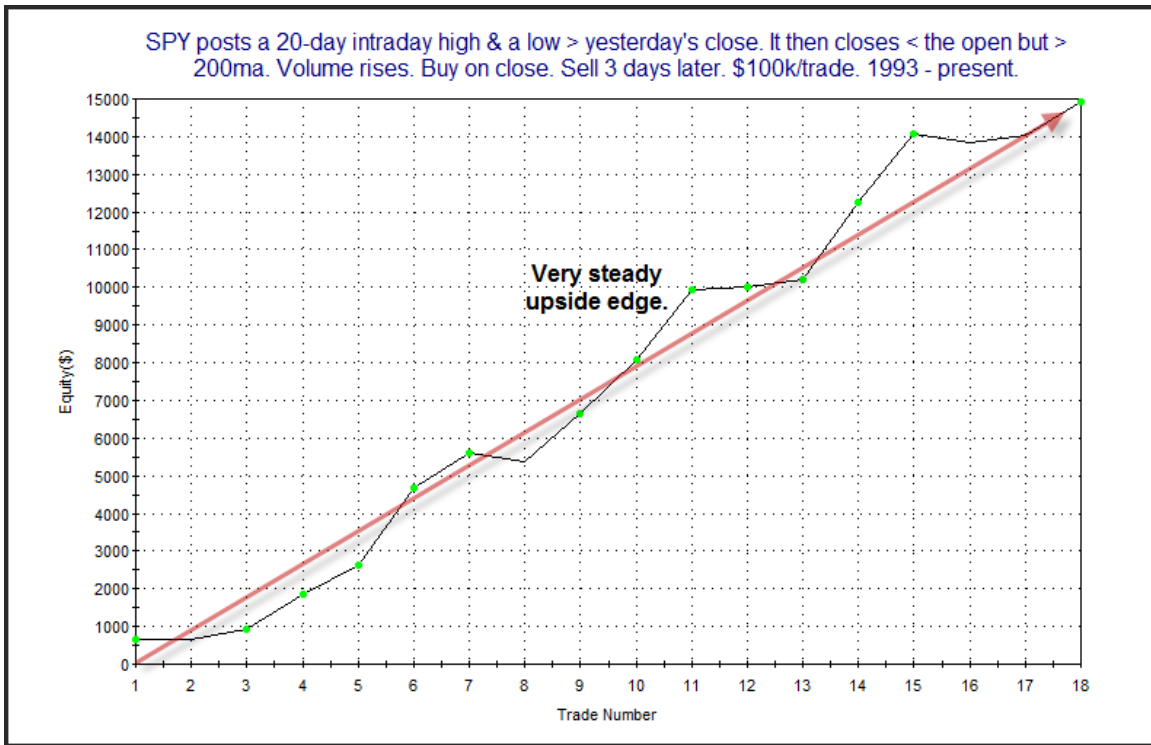
I also added another filter to see what a rise in SPY volume might mean.

**SPY posts a 20-day intraday high & a low > yesterday's close. It then closes < the open but > 200ma. Volume rises. Buy 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: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
12	23,127.66	16	13	3	81.25	2,235.79	-1,979.19	1.13	4.90	1,445.48
11	28,350.23	17	15	2	88.24	2,149.39	-1,945.29	1.10	8.29	1,667.66
10	24,706.04	17	11	6	64.71	2,776.17	-971.98	2.86	5.24	1,453.30
9	19,259.24	17	13	4	76.47	1,834.13	-1,146.11	1.60	5.20	1,132.90
8	17,837.70	17	12	4	70.59	1,883.60	-1,191.36	1.58	4.74	1,049.28
7	16,897.79	17	11	6	64.71	2,034.66	-913.91	2.23	4.08	993.99
6	17,039.86	17	12	5	70.59	1,888.18	-1,123.67	1.68	4.03	1,002.34
5	11,859.77	17	9	8	52.94	1,772.02	-511.05	3.47	3.90	697.63
4	14,450.64	17	13	4	76.47	1,217.90	-345.53	3.52	11.46	850.04
3	14,933.31	18	15	2	83.33	1,028.62	-247.98	4.15	31.11	829.63
2	9,312.73	19	12	7	63.16	1,009.49	-400.16	2.52	4.32	490.14
1	6,942.64	19	14	5	73.68	595.21	-278.07	2.14	5.99	365.40

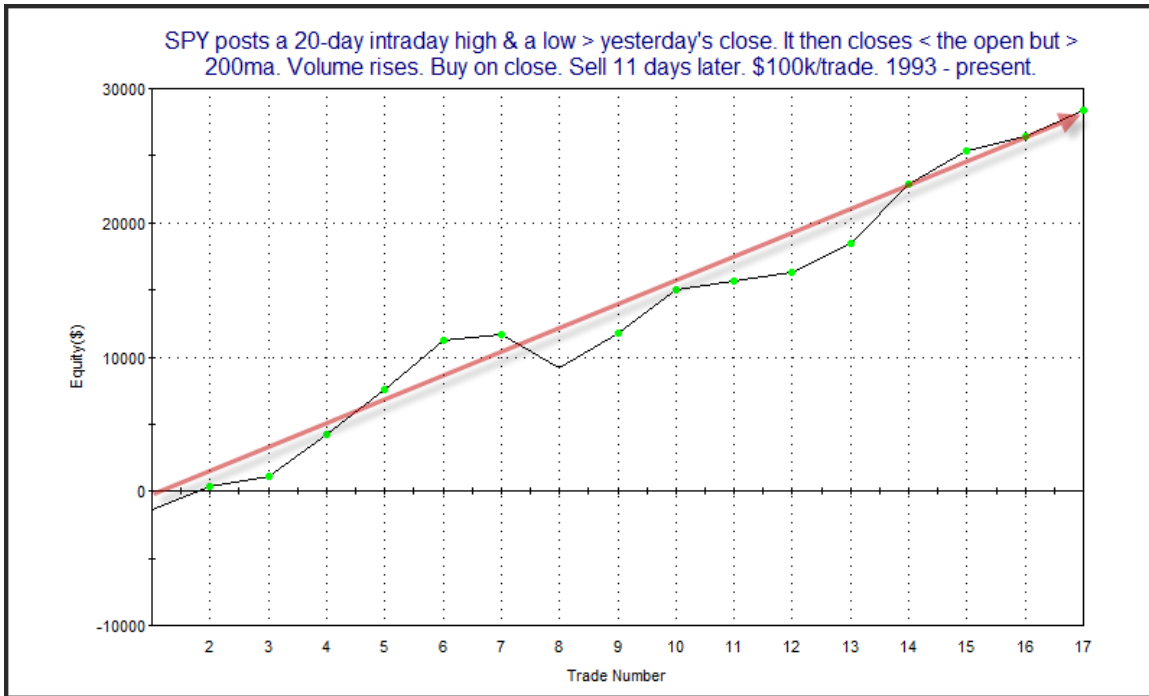
**18 of 19 instances (95%) posted a close above the entry price at some point in the next 3 days.**

Results here appear solid all around and the edge even plays out a little longer than the 3-4 days of the previous study. To get an idea of how the edge has looked over time I have created an equity curve using a 3-day exit below.



Equity curves don't often get much straighter than this.

In addition to the December 30<sup>th</sup> study I also generated an equity curve using an 11-day exit strategy. That curve can be found below.



Like the 3-day curve, the edge here appears incredibly consistent. Rarely do 1-day price patterns provide such steady and persistent edges.

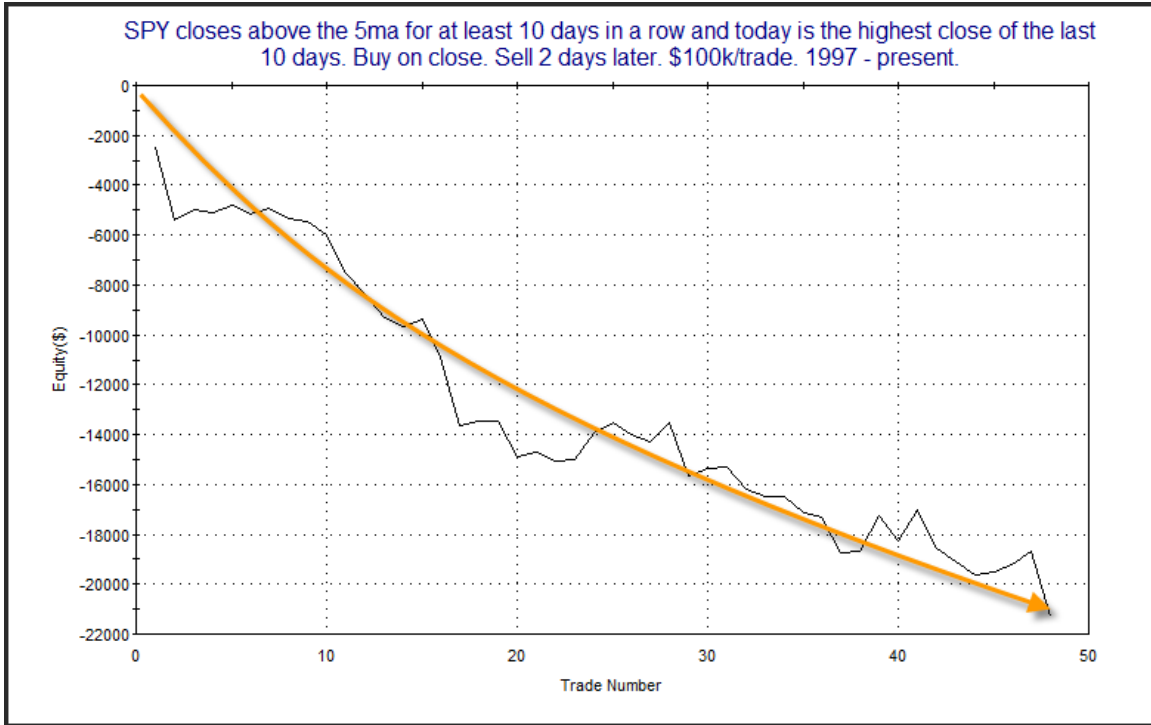
But not everything is coming up roses. The rally over the last two weeks has been relentless. It is now reaching a point where rallies in the past have greatly struggled to continue higher without a pullback. The study below was last seen in the February 17, 2011 Subscriber Letter. It triggered again on Friday.

SPY closes above the 5ma for at least 10 days in a row and today is the highest close of the last 10 days. Buy on close. Sell X days later. \$100k/trade. 1997 - 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	-10,133.49	35	20	15	57.14	752.39	-1,678.75	0.45	0.60	-289.53
4	-16,600.75	37	15	22	40.54	679.41	-1,217.81	0.56	0.38	-448.67
3	-19,053.15	43	14	29	32.56	653.54	-972.51	0.67	0.32	-443.10
2	-21,298.76	48	19	28	39.58	414.70	-1,042.07	0.40	0.27	-443.72
1	-21,122.60	68	27	41	39.71	316.22	-723.43	0.44	0.29	-310.63

**90% of instances posted a close above the entry price at some point in the next 4 days.**

As you can see, there has almost always been a short-term pullback. The downside edge doesn't last long, though. It seems to pretty much play itself out over the first 2-3 days. Below is an equity curve showing how the edge has played out over time. It uses a 2-day exit strategy.



This also appears to provide a fairly consistent downside edge.

So we have one bullish and one bearish study tonight - both offering fairly compelling evidence. This happens, and it's not terribly unusual. It's also a primary reason I developed a tool like the Aggregator to help me weight all the evidence being presented.

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



The green Aggregator line remained marginally above 0 tonight. 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 is 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 remained flat at the close.

At this point the green Aggregator line is set to close very near 0 on Monday. New evidence that emerges will have a strong impact on where the Aggregator finishes. It will therefore be important to monitor the Quantifinder during the day if you wish to get a heads up on what is likely to trigger. Meanwhile, the Differential Pivot will be 1,326.47. This is about 0.5% below Friday's close. For the Differential line to move back above 0 the SPX will need to drop at least this much.

So momentum is strong and Friday's action along with seasonality and the breadth study from Thursday are all suggesting more upside. There are some warning signs suggesting increased risk as the market is over-extended in the short-term. I typically stand aside when things get overheated and await a pullback or at least a few days of underperformance versus expectations before stepping back in. There is always the risk that the market continues higher without me but I prefer that risk to dealing with potential whipsaws. So should the market pull back in the next couple of days I'll likely look to take advantage of that.

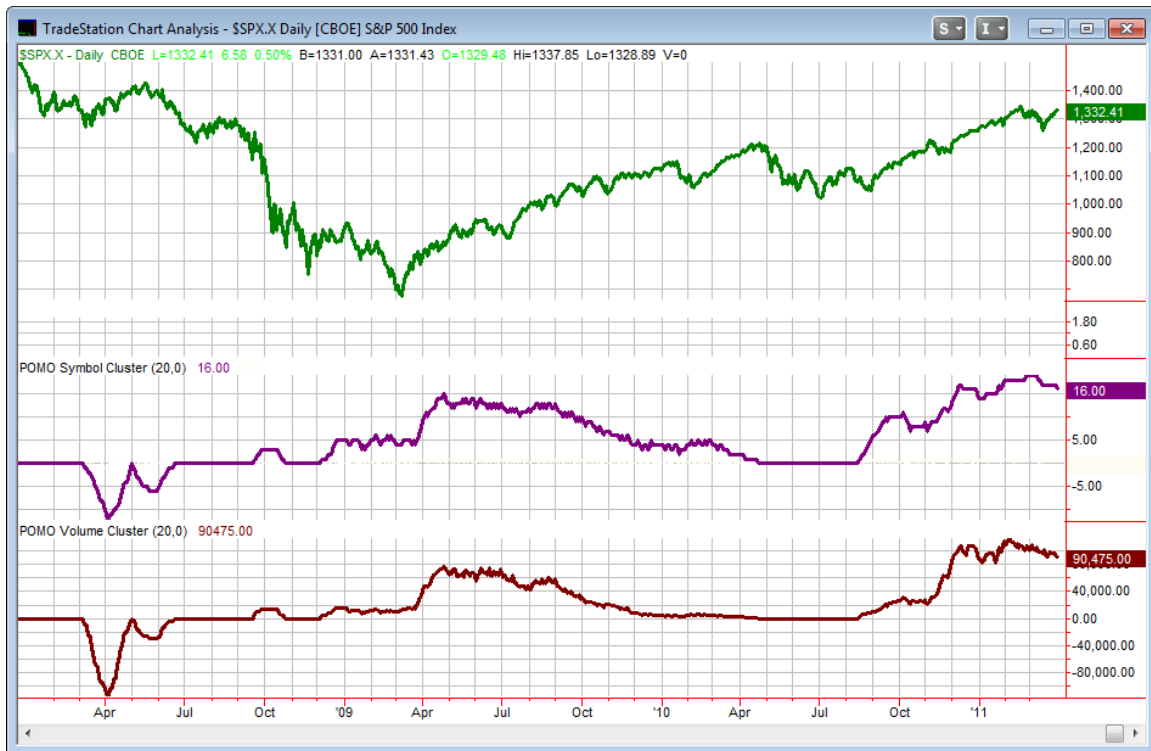
***Intermediate-term Outlook (2 weeks – 2 months)– updated 4/4 – bullish***

What felt to many like a scary drop just a couple of weeks ago has now almost completely recovered and the market is nearing new highs. The SPX is only about 1% from a new high, and the Russell 2000 is already there.

The Fed's current POMO activity 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 3<sup>rd</sup> POMO presentation linked below. (Not available for trial users.)*

<http://www.quantifiableedges.com/members/pomo.php>



The POMO Days indicator remains strong at 16. According to the tentative operations schedule we should see additional POMO buying Monday-Thursday of this upcoming week before an off-day on Friday. POMO Volume has declined a bit recently but still remains at a high level. 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](http://www.newyorkfed.org/markets/tot_operation_schedule.html)

There is still a decided lack of intermediate-term bearish studies. Meanwhile, momentum, POMO activity, and breadth are all pointing higher. I remain intermediate-term bullish. 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.*

*None tonight.*

## **Current Open Trade Ideas**

*None.*

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