

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 5, 2011

Volume 4 Issue 65

Market Overview



Tonight's Research Points

- SPX and VIX both up on a Monday suggests a downside edge for Tuesday.
- SPY closing at a 10-day high on the lowest volume in 20-days is commonly followed by a short-term pullback. This even holds true during uptrends.
- The Aggregator System is short.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook

The Bottom Line

The evidence is beginning to turn bearish and the market is overbought. With the intermediate-term outlook still bullish I will cautiously begin to take on short exposure.

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 5, 2011	SPY 10-high on 20-day low volume	1-4 days	Bearish	-1.70%
April 5, 2011	SPX up. VIX up. Monday	1 day	Bearish	
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%
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.

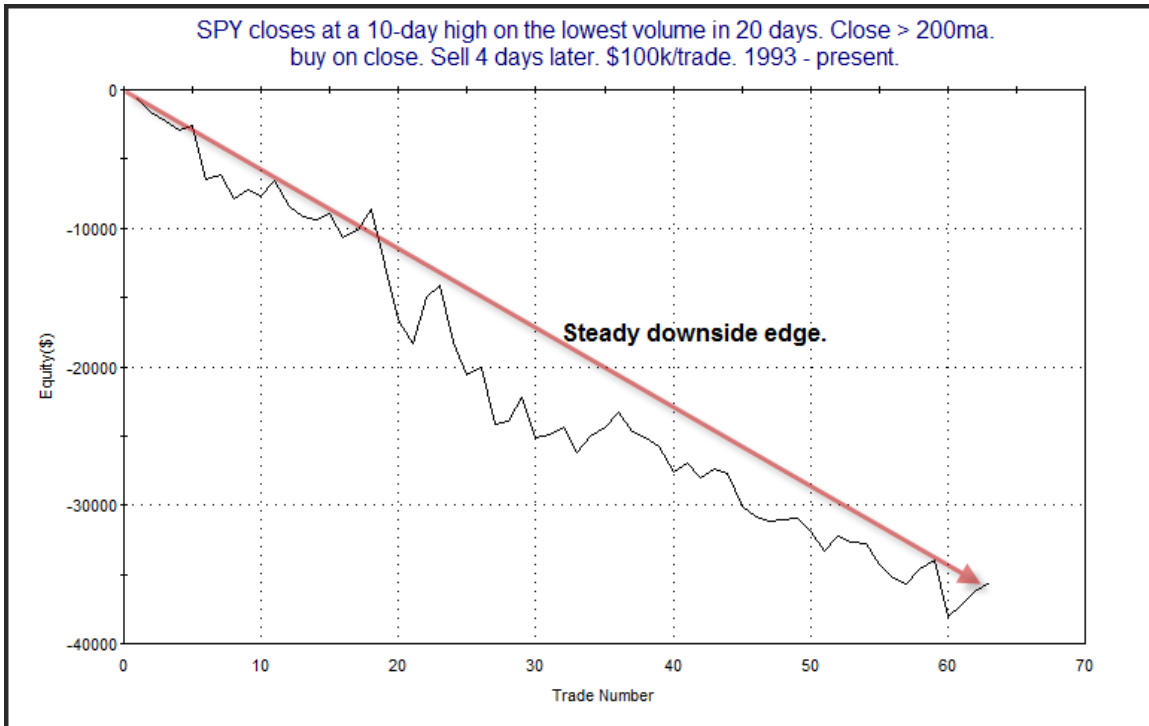
The Evidence

Not much market action on Monday. The SPX never wandered more than a few points from breakeven. And though it spent most of the afternoon in negative territory, a last-minute surge brought it just above breakeven. In the end the SPX rose 0.03%, the Nasdaq dropped 0.01%, and the Russell 2000 gained 0.32%. Breadth was mixed as the NYSE Up Issues % came in at 53% but the Up Volume % was just below 50%. Total volume came in quite low – just above the lowest levels of the last month.

While NYSE volume didn't quite hit a 1-month low, SPY volume did. Extremely low SPY volume while SPY is hitting new highs is often followed by a pullback. I last examined this in the 2/9/11 Subscriber Letter. I have updated that study below.

SPY closes at a 10-day high on the lowest volume in 20 days. Close > 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
5	-21,585.73	62	29	33	46.77	991.11	-1,525.09	0.65	0.57	-348.16
4	-35,577.03	63	27	36	42.86	810.81	-1,596.36	0.51	0.38	-564.71
3	-29,441.81	63	25	38	39.68	754.66	-1,271.27	0.59	0.39	-467.33
2	-31,109.04	66	23	42	34.85	588.86	-1,063.16	0.55	0.30	-471.35
1	-13,244.97	68	23	45	33.82	477.31	-538.29	0.89	0.45	-194.78

Results here appear to suggest a bit of a downside edge. Below is an equity curve using a 4-day exit strategy.



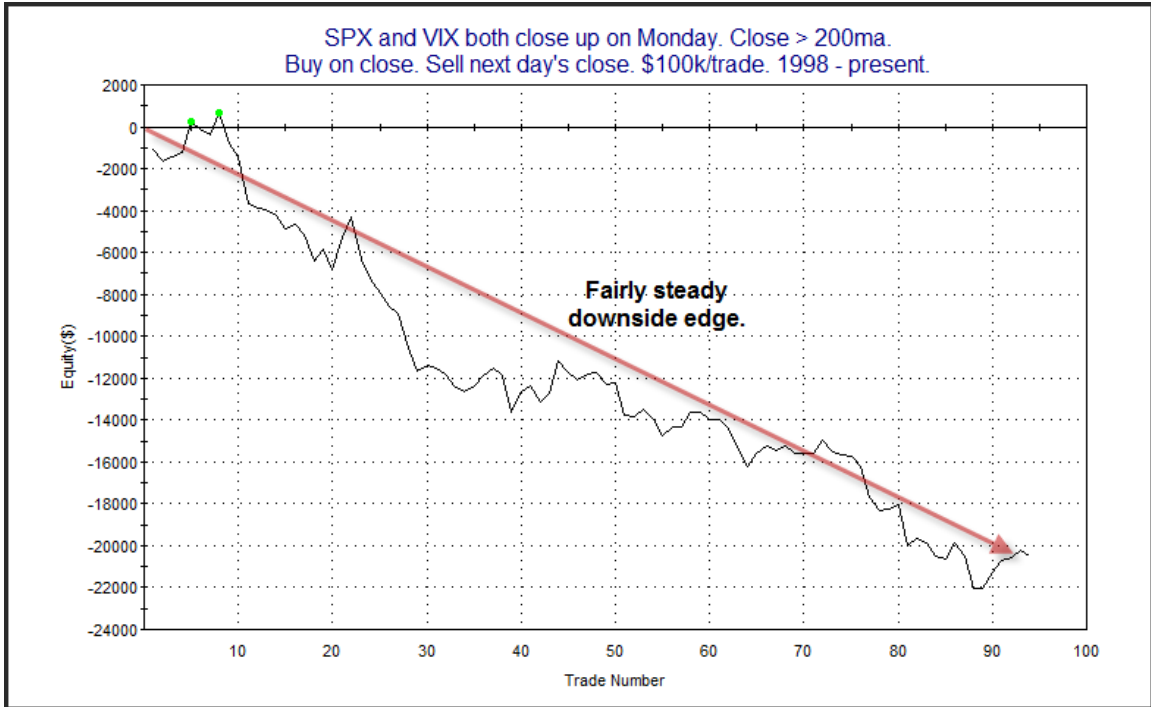
The steady downslope serves as a nice confirmation of the edge suggested by the results table. It is especially impressive considering the fact that the SPX is above the 200ma.

Also notable on Monday was that the VIX ended higher along with the SPX. It's a bit unusual for the SPX and the VIX to close in the same direction. Historically, when they both close higher there has been some giveback from the S&P over the next few days. One quirk with the VIX though is that it has a tendency to fall on Fridays and rise on Mondays. Therefore this setup is more common on Mondays than any other day of the week. This condition was last present and discussed in the 2/15/11 subscriber letter. I've again updated the study below.

SPX and VIX both close up on Monday. Close > 200ma.
Buy on close. Sell X days later. \$100k/trade. 1998 - present.

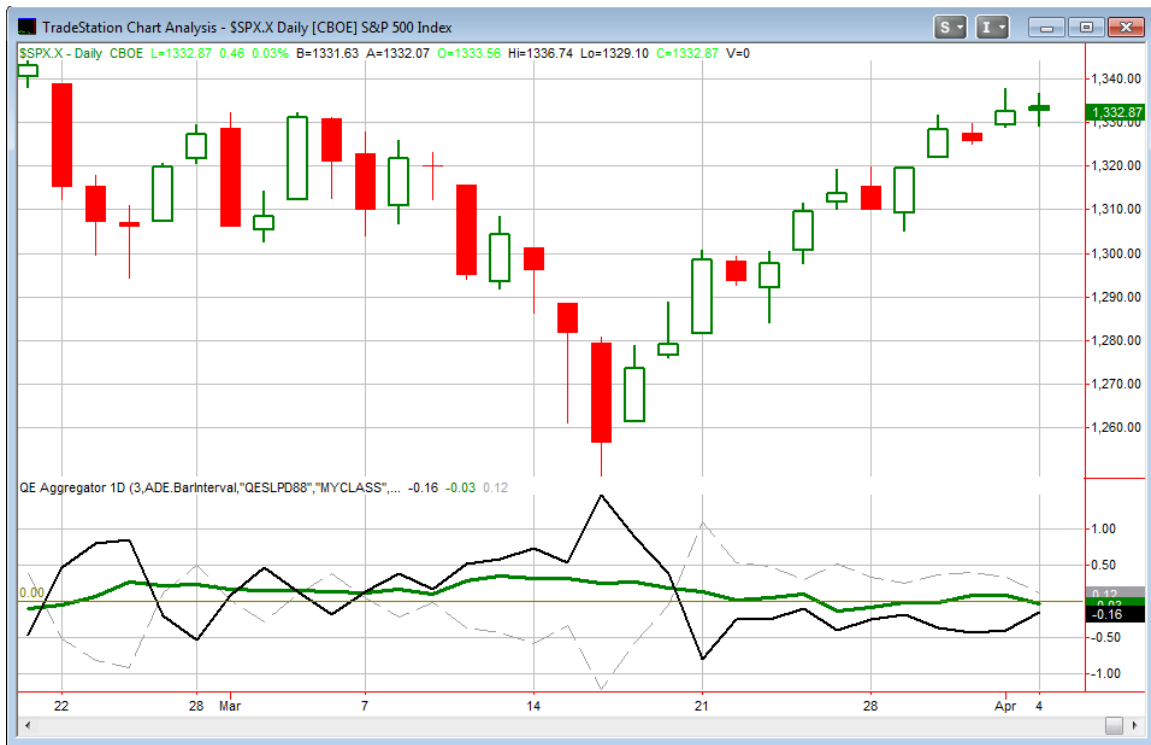
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-1,369.43	91	47	44	51.65	1,453.90	-1,584.15	0.92	0.98	-15.05
4	-7,311.71	94	46	48	48.94	1,253.82	-1,353.90	0.93	0.89	-77.78
3	-13,082.51	94	45	49	47.87	1,014.31	-1,198.50	0.85	0.78	-139.18
2	-17,887.53	94	42	52	44.68	724.82	-929.42	0.78	0.63	-190.29
1	-20,504.77	94	38	56	40.43	469.09	-684.47	0.69	0.47	-218.14

This appears to suggest a 1-day edge. Below is the equity curve so you can see how it has played out over time.



For a bearish study above the 200ma the edge shown here has been pretty consistent. I've included this among the active studies.

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



Tonight's bearish studies dropped the green Aggregator line below 0. The negative value means the net expectation from the Active Studies List is for downside 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 mild downside and the SPX is relatively overbought. Historically, this combination has suggested a bearish edge. It can be seen on the chart whenever both lines are below 0. Due to this the Aggregator System turned short at the close.

At this point the green Aggregator line is set to close below 0 again on Tuesday. This could change should bullish evidence emerge. Meanwhile, the Differential Pivot will be 1,326.26. This is about 0.5% below Monday's close. For the Differential line to move back above 0 the SPX will need to drop at least this much.

So bearish evidence is now taking the lead with the market a bit overbought. Bearish studies have been run over a bit lately, and the intermediate-term outlook is still bullish. So as I tend to do in situations like this, I will dip my toe into the short side and look to trade it conservatively. Details in the trade ideas section below.

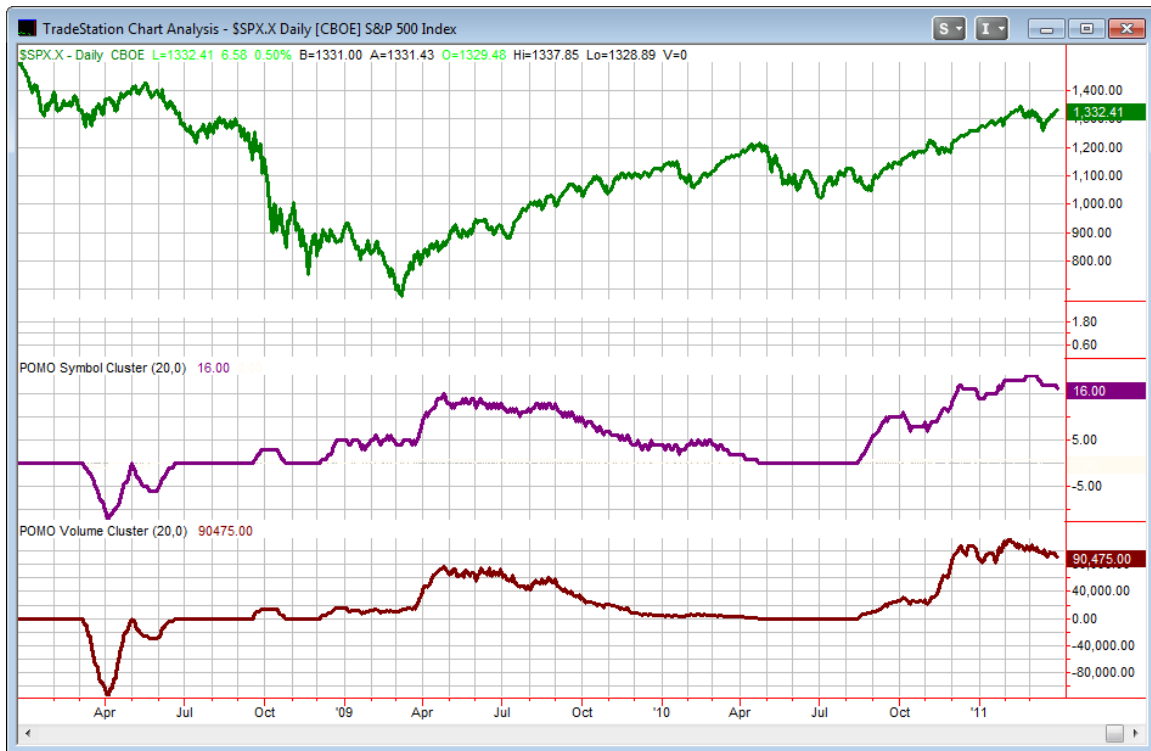
Intermediate-term Outlook (2 weeks – 2 months)– updated 4/4 – bullish

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 3rd 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

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.

*SPY – short 1/4 index position @ \$133.26 limit. Based on the short-term outlook above. **Should the SPX close at or below the Differential Pivot of 1,326.26 then I will exit this position on the close.***

Current Open Trade Ideas

None.

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