

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 7, 2011

Volume 4 Issue 67

Market Overview



Tonight's Research Points

- 10 days above the 5ma and a new 10-day high suggest the market is due for a brief pullback.
- The low 3/10 Offset HV indicator suggests a possible volatility expansion.
- The Aggregator System is short.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook

The Bottom Line

The Aggregator is again suggesting a mild downside edge. I will once again look to dip my toe in the short side.

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 7, 2011	10 day > 5ma & a 10-day high.	1-2 days	Bearish	-1.20%
April 6, 2011	SPX down. Up Issues % > 55%	1-3 days	Bullish	1.20%
April 5, 2011	SPY 10-high on 20-day low volume	1-4 days	Bearish	-1.70%
April 4, 2011	Unfilled gap. 20-day high. Close < open.	1-4 days	Bullish	1.40%
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	
Dropped Tonight				
April 1, 2011	Early April seasonally strong	1-4 days	Bullish	

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

The Evidence

The stock market seems to have stopped moving. Today the SPX rose 0.2%, the Nasdaq was up 0.3% and the Russell 2000 gained 0.1%. Breadth was moderately positive as the NYSE Up Issues % came in at 57% and the Up Volume % was 62%. Total NYSE volume rose to the highest level since 3/31.

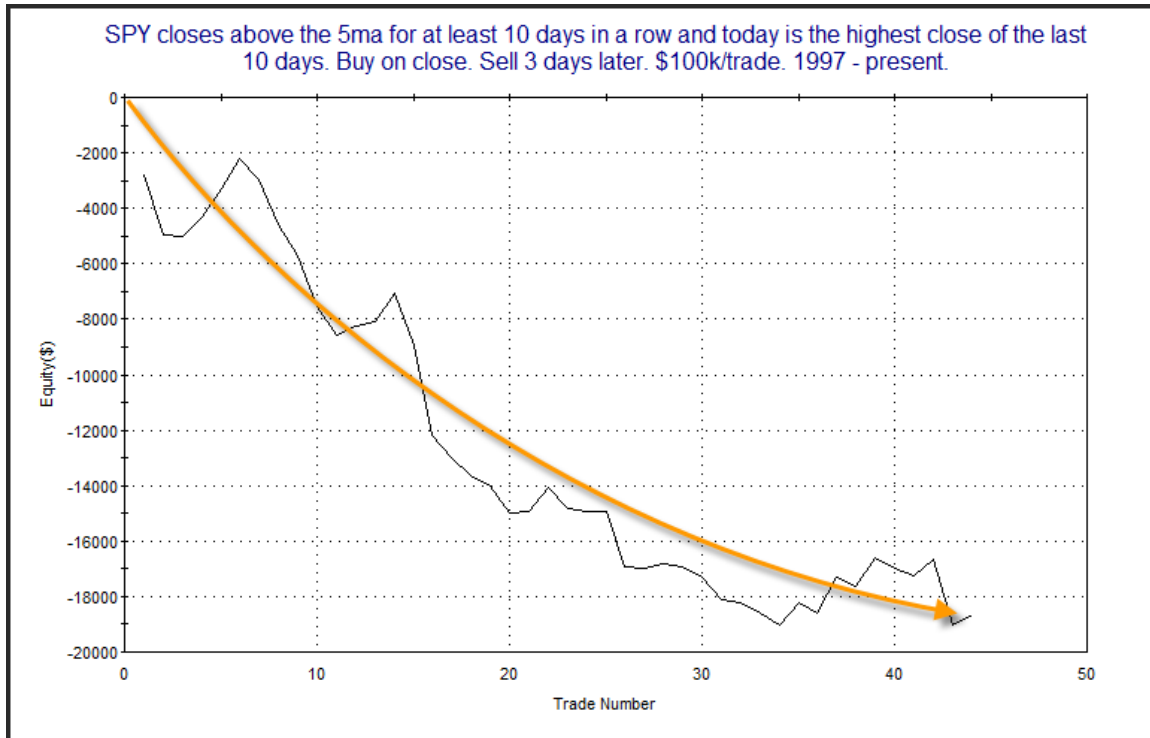
Another new rally closing high without a dip below the 5ma again triggered the below study, which was last seen in the 4/4/11 letter just 3 nights ago.

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	-18,670.14	44	15	29	34.09	635.50	-972.51	0.65	0.34	-424.32
2	-21,231.17	49	20	28	40.82	397.34	-1,042.07	0.38	0.27	-433.29
1	-21,054.99	70	28	42	40.00	307.87	-706.56	0.44	0.29	-300.79

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

In the past this setup has almost always been followed by 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 evolved over time. It uses a 2-day exit strategy.



While perhaps not as strong as it once appeared, there still seems to be a decided downside edge.

Also notable about current conditions is that the 3/10 Offset Historical Volatility Indicator came in at an extremely low 0.18 on Wednesday. I [first introduced this indicator in July of 2009](#). It essentially takes a short 3-day measure of Historical Volatility and compares that to the 10-day measure of 3-days ago. Low readings indicate there has been a contraction in volatility. High numbers indicate there has been an expansion. Anything below 0.25 is regarded as extremely low. Often after sharp contractions like this we often see a volatility expansion take place. In August of 2009 I published a study that found this condition created a favorable environment for trading Opening Range Breakouts. A link to that study is below:

[Quantifiable Edges ORBs Study.pdf](#)

For anyone who is interested in seeing some techniques for actually trading these ORBs, there is a webinar from October 2010 on the subject on the videos page.

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

It's important to note that the 3/10 Offset HV indicator predicts volatility, not direction. For direction I look to the Aggregator. As you'll find out below the Aggregator is bearish tonight. Therefore, should the market consolidate during the early morning Thursday, I may look to short a breakdown of that opening range.

Of further note, the 3/10 Offset HV Calculation is available as part of the new "QE Indicators/Functions for Tradestation". Subscribers may download it to include on their own charts. I'll be discussing this indicator in the subscriber webinar on Tuesday and happy to answer questions on it at that time. A link to the new Indicators page is below, where you may download the User Guide or the Tradestation ELD.

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

I should also note that the indicator is designed not only for charts, but may be applied to Radarscreen as well. By adding it as a column on Radarscreen you can find candidates for trading ORBs on a more regular basis. Some ETF's that are showing extremely low 3/10 Offset HV's right now include EWU, IWS, IWV, IYR, IWM, and IJS. So it appears that any of these might provide a possible ORB trading opportunity.

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



It's difficult to see in the above chart but the green Aggregator line dipped very slightly and went from just above to just 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 marginally 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 downside edge. It can be seen on the chart whenever the green Aggregator and black Differential lines both close < 0 . Due to this the Aggregator System turned short at the close.

At this point the green Aggregator line is set to remain below 0 on Thursday. This could change should bullish evidence emerge. Meanwhile, the Differential Pivot will be 1,334.59. This is less than 0.1% below Wednesday's close. So for the Differential line to move back to positive and the SPX to be considered "underperforming" versus expectations, the SPX would need to close only 0.1% lower.

This overbought market has led the Aggregator to take a few quick stabs at the short side in the last week and a half or so. So far results have been only a hair better than breakeven. Wednesday's action now has a new Aggregator short signal triggering. I'll again look to take advantage of a potential downside edge. And I'll again tread lightly being that we are looking at a trade that is both counter-trend and counter to my intermediate-term outlook.

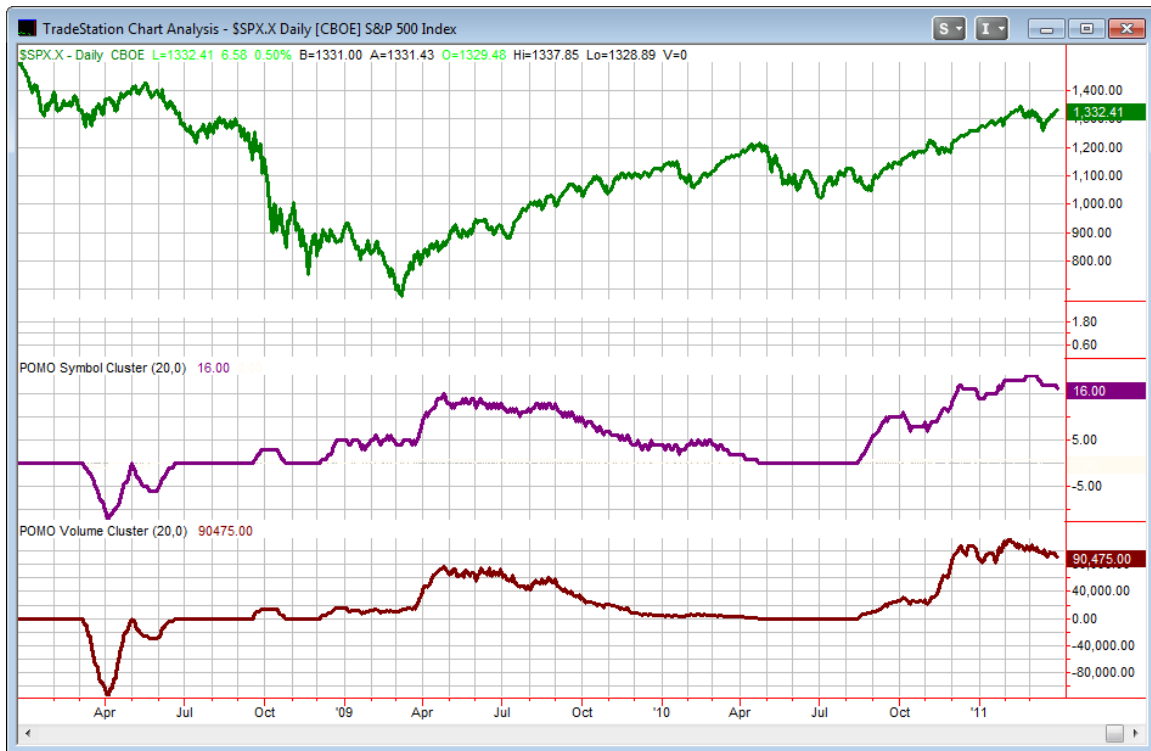
Intermediate-term Outlook (2 weeks – 2 months)– updated 4/4 – bullish

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 @ \$133.66 LIMIT. Based on short-term outlook above.

While I wouldn't attempt to trade and track it in the subscriber letter, an ORB trade (especially to the short side) may also be something to consider.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	4/5/2011	\$133.26	\$133.24	0.02%		covered at limit

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