

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 25, 2011

Volume 4 Issue 78

## Market Overview



## Tonight's Research Points

- 3 up days with the most recent occurring on lower volume only suggests a downside edge during a long-term downtrend. Doesn't mean anything currently.
- 2 VIX closes under its lower Bollinger Band suggests a short-term SPX pullback.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is flat.

## Short-term Outlook

### The Bottom Line

Evidence is mixed. The SPX is overbought versus recent expectations. I'm short-term neutral and waiting for better opportunities before committing additional capital.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
April 25, 2011	VIX < lower BB 2 in a row. SPX > 200ma	1-2 days	Bearish	-1.05%
April 21, 2011	Unfilled gap up. 2nd day up. No 10 high	1-3 days	Bullish	
April 20, 2011	WR7 Down High Vol then NR7	1-5 days	Bullish	2.10%
April 19, 2011	1% drop & decliners double advancers	1-9 days	Bullish	3.00%
<b>Active - Long Term</b>				
April 25, 2011	Nas/SPX relative strength favors Nas	int term	Bullish	
April 11, 2011	QQQ 5 lower lows. Today worst day.	1-20 days	Bullish	13.00%
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>				
<b>April 20, 2011</b>	<b>Holy Thursday</b>	<b>1 day</b>	<b>Bullish</b>	

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

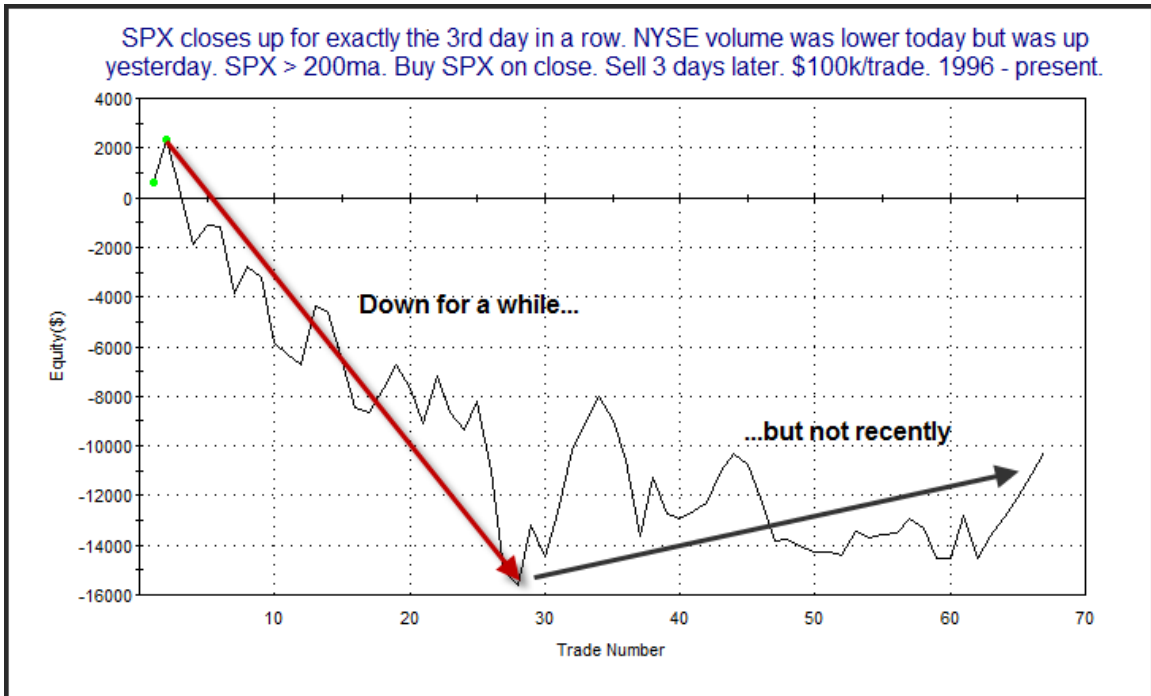
### *The Evidence*

Bullish tendencies held firm on Thursday. The market gapped higher for the 2<sup>nd</sup> day in a row. The open was very close to the high of the day, but so was the close. Action was typically light as happens before long weekends. In the end the SPX, Nasdaq, and Russell 2000 all gained between 0.5% and 0.75%. Breadth was squarely positive as the NYSE Up Issues % came in at 65% and the Up Volume % was 62%. Total NYSE volume shrank as traders (like me) took some time off.

I don't find the low volume to be of any significance since as I mentioned, it was pre-holiday trading. Still, a few volume-related studies appeared that looked at the 3-day rally on the SPX and the lower volume. I thought I would break it down a bit further out of interest. One study that appeared looked at 3 up closes and lower volume on at least one of the last 2 days. Tonight I looked more specifically at the volume, requiring today to be down but yesterday to be up. I found that it painted a different picture depending on whether you are in an uptrend or a downtrend. Let's first look at uptrends.

SPX closes up for exactly the 3rd day in a row. NYSE volume was lower today but was up yesterday. SPX > 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1996 - 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	3,176.78	63	35	28	55.56	1,536.70	-1,807.42	0.85	1.06	50.43
4	-5,936.43	67	34	33	50.75	1,300.99	-1,520.31	0.86	0.88	-88.60
3	-10,252.66	67	31	36	46.27	1,072.97	-1,208.74	0.89	0.76	-153.02
2	-7,024.04	67	32	35	47.76	749.87	-886.28	0.85	0.77	-104.84
1	-2,492.91	67	30	37	44.78	450.20	-432.40	1.04	0.84	-37.21

There appears to be a mild downside edge over the 1<sup>st</sup> 3 days when looking at the stats. The equity curve tells a slightly different story, though.



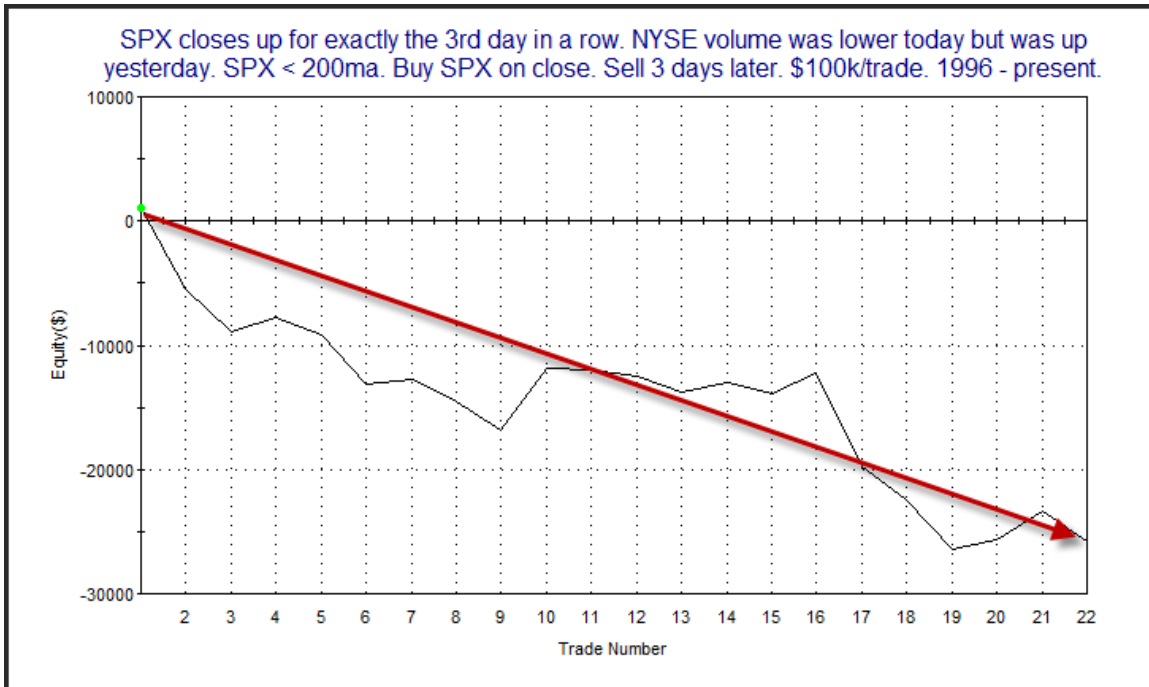
Here it appears that this setup may have suggested downside inclinations in the past but that is no longer the case.

But what of times where the setup has occurred below the 200ma?

SPX closes up for exactly the 3rd day in a row. NYSE volume was lower today but was up yesterday. SPX < 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1996 - 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	-19,857.24	22	10	12	45.45	2,053.41	-3,365.95	0.61	0.51	-902.60
4	-17,612.57	22	9	13	40.91	1,671.68	-2,512.13	0.67	0.46	-800.57
3	-25,732.59	22	8	14	36.36	1,615.99	-2,761.46	0.59	0.33	-1,169.66
2	-16,435.53	22	8	14	36.36	1,355.86	-1,948.74	0.70	0.40	-747.07
1	-12,272.60	22	7	15	31.82	1,174.60	-1,366.32	0.86	0.40	-557.85

The stats here appear quite strong, and the equity curve...



..confirms the downside edge suggested by the stats. Of course we aren't in a downtrend now, but this appears worthy of including in the Quantifinder going forward.

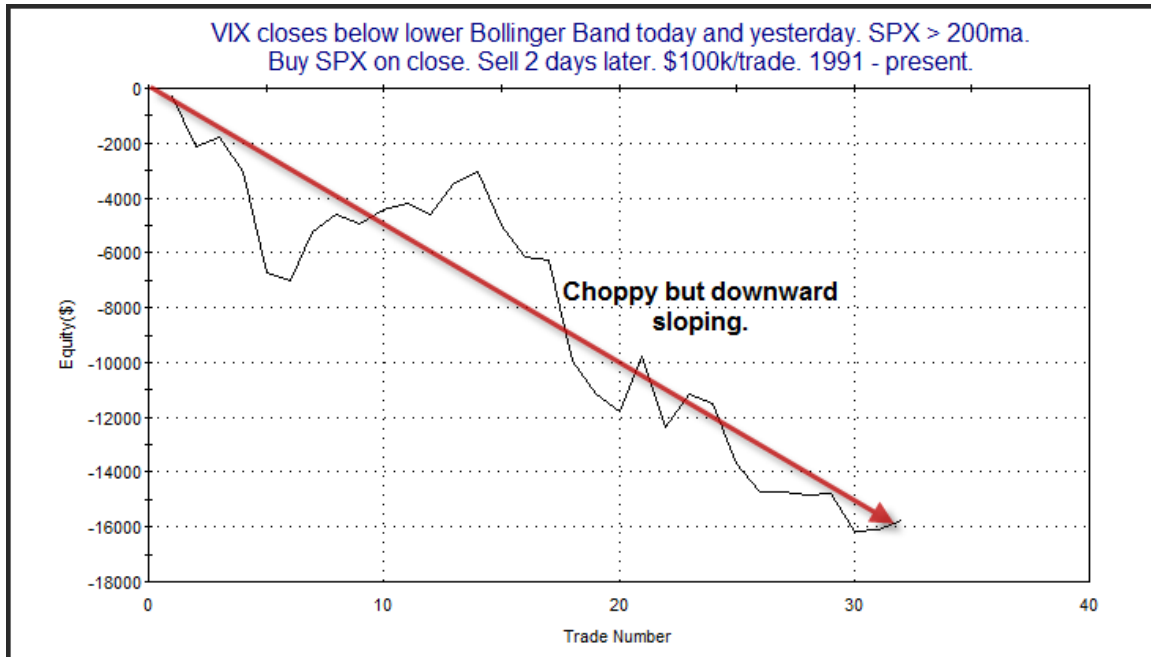
One possible concern I have is the fact that the VIX is getting stretched quite low – suggesting possible complacency. In fact, it closed below its Bollinger Bands for the 2<sup>nd</sup> day in a row on Thursday. I looked at other times this has happened while the SPX was above its 200ma.

VIX closes below lower Bollinger Band today and yesterday. SPX > 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1991 - 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	-15,614.31	28	9	19	32.14	1,943.33	-1,742.33	1.12	0.53	-557.65
4	-19,063.23	28	12	16	42.86	1,062.94	-1,988.66	0.53	0.40	-680.83
3	-8,345.66	30	16	14	53.33	923.04	-1,651.02	0.56	0.64	-278.19
2	-15,746.16	32	13	19	40.63	666.49	-1,284.76	0.52	0.35	-492.07
1	-8,920.61	43	18	25	41.86	531.38	-739.42	0.72	0.52	-207.46

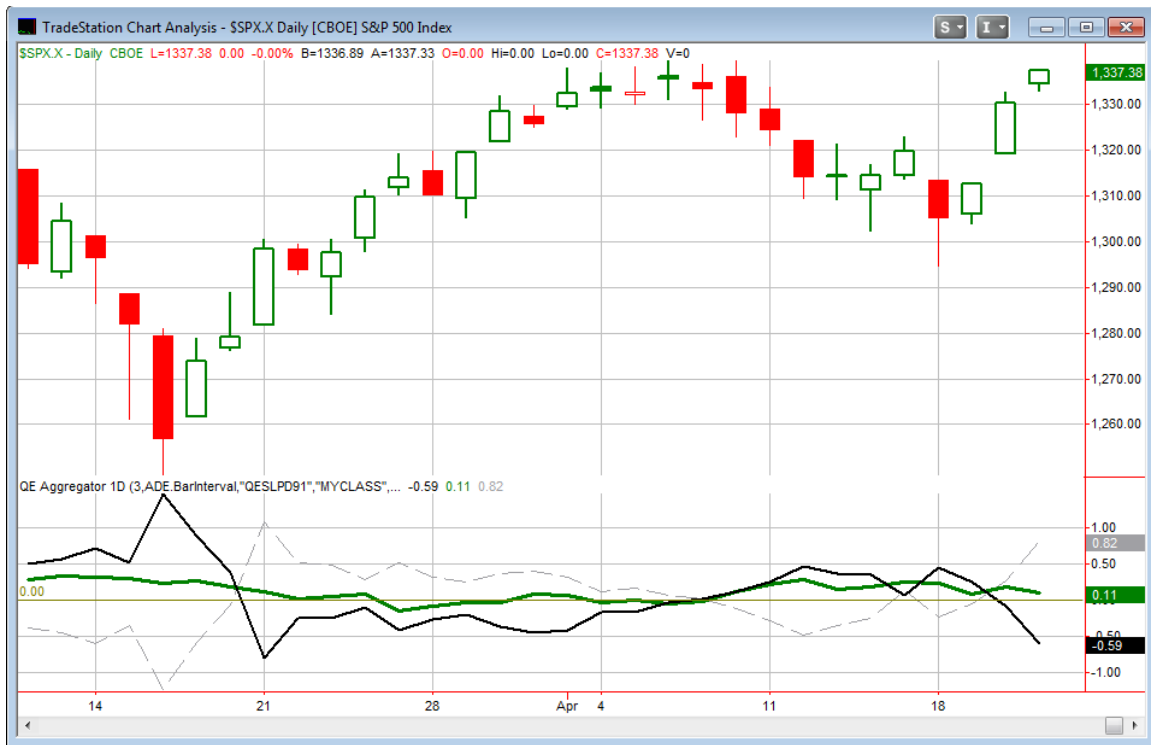
**87.5% of instances closed below the entry price at some point in the next week.**

The stats here appear to suggest bearish inclinations, which mostly play out over the 1<sup>st</sup> 2 days. Below is an equity curve using a 2-day holding period.



The equity curve seems to support the idea that there is a bit of a downside edge.

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



Even with tonight's VIX study the green Aggregator line remains well above 0. 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 fell further 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 already quite overbought. This is considered a neutral configuration. A neutral configuration is visible on the chart whenever the green Aggregator and black Differential lines finish on opposite sides of zero. Due to this the Aggregator System remained flat.

The green Aggregator line is again set to close above 0 on Monday. This could change if more bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,319.85. This is about 1.3% below Thursday's close. This means it would take a drop of at least this much to turn the black Differential line positive.

One-day expectations are actually very slightly negative. This is reflected in the -1 reading for the 1-day Risk/Reward Outlook at the top of the letter. It isn't a strong enough inclination for me to attempt a swing trade, but if I was daytrading on Monday I might be inclined to favor the short side a bit more than the long side. With a neutral outlook I'm not looking to add more exposure. Instead, I'll exercise some patience and wait for a more pronounced edge to emerge before risking more capital.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 4/25 – bullish***

After 2 down weeks the market made some nice gains this past week. One encouraging sign in addition to prices rising is that the Nasdaq is now taking leadership back over from the SPX. For relative strength I use a 10-week measure. The chart below is updated each week on the charts page. Detailed write-ups for those who would like a refresher may be found using the following links.

<http://quantifiableedges.blogspot.com/2009/05/simple-powerful-timing-indicator.html>

<http://quantifiableedges.blogspot.com/2009/06/tweaking-nasdaq-leadlag-model.html>

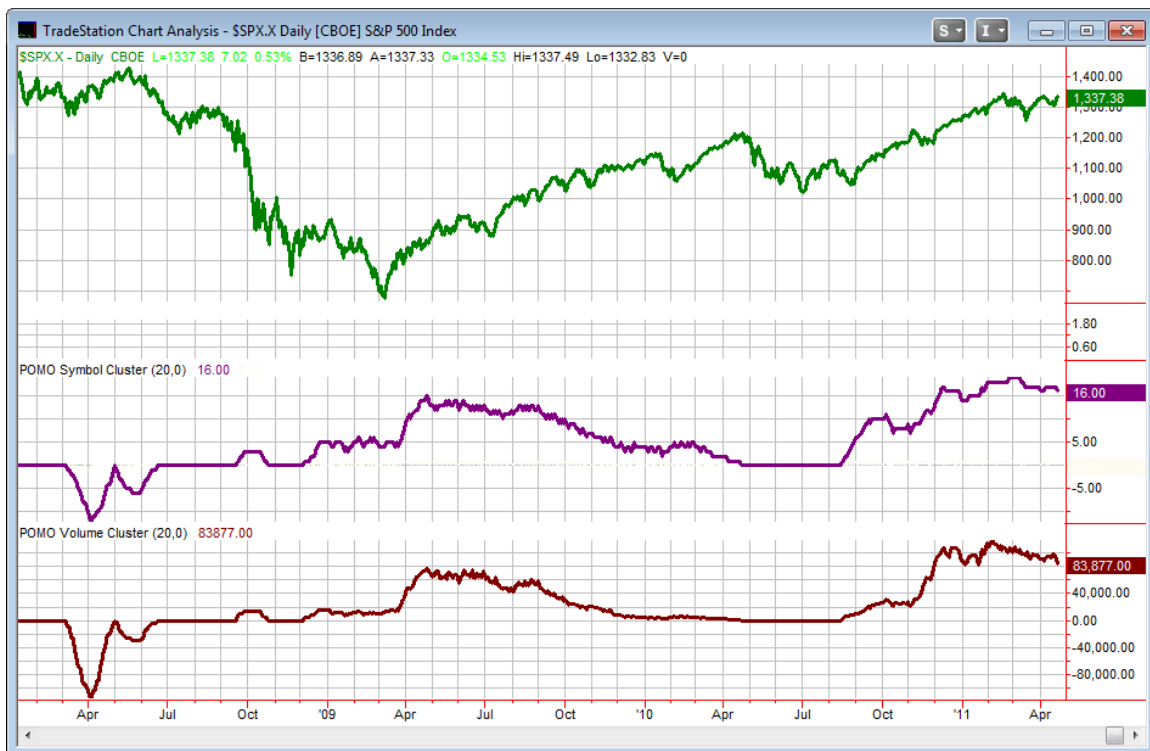


The basic idea is that the market tends to perform better when the Nasdaq leads the SPX. Historically, the SPX has made its money when the Nasdaq has been in leading position, and struggled to make headway when the Nasdaq has lagged. Looking at the action over the recent 11 months or so in the above chart, you can see this tendency has generally held true. Therefore, I view the Nasdaq's recent leadership as an intermediate-term 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 indicators have pulled back a little recently. The days indicator is at 16 and the POMO Volume indicator is down near the low end of its recent range. The schedule

calls for buying every day this week except for Wednesday. And the 1<sup>st</sup> week in May there is buying scheduled every day. So with 9 of the next 10 days scheduled for buying I don't expect to see these indicators drift lower. I instead expect POMO to continue to act as a wind at the markets back. Monitoring POMO activity and news will become increasingly important as we near the end of the QE2 stimulus in June.

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, breadth, relative strength, and QQQ price action 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.

No new trade ideas tonight.

### **Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
EPP	4/19/2011	\$48.85	\$50.73	3.85%		System 90609

*EPP is making new highs and is nowhere near an exit based on system 90609.*

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