

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 29, 2011

Volume 4 Issue 82

Market Overview



Tonight's Research Points

- The very-low VIX:VXV ratio while SPX is at a 50-day high suggests short-term weakness.
- Volume action is mixed.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook

The Bottom Line

Same story. Expectations remain positive but the SPX is still overbought. I still won't look to add more exposure until a lower risk setup avails itself.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
April 29, 2011	VIX:VXV < 0.85. SPX at 50-high.	1 day	Bearish	
April 28, 2011	100-day high on a Fed Day	1-6 days	Bullish	1.65%
April 27, 2011	Unfilled gap to new 50-day high	1-5 days	Bullish	1.70%
Active - Long Term				
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	
Dropped Tonight				
April 27, 2011	SPY 8-day avg closing range > 75%	1-2 days	Bearish	-1.40%
April 26, 2011	Low vol 20. SPX > 10ma & 2--ma.	1-2 days	Bearish	-1.10%

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

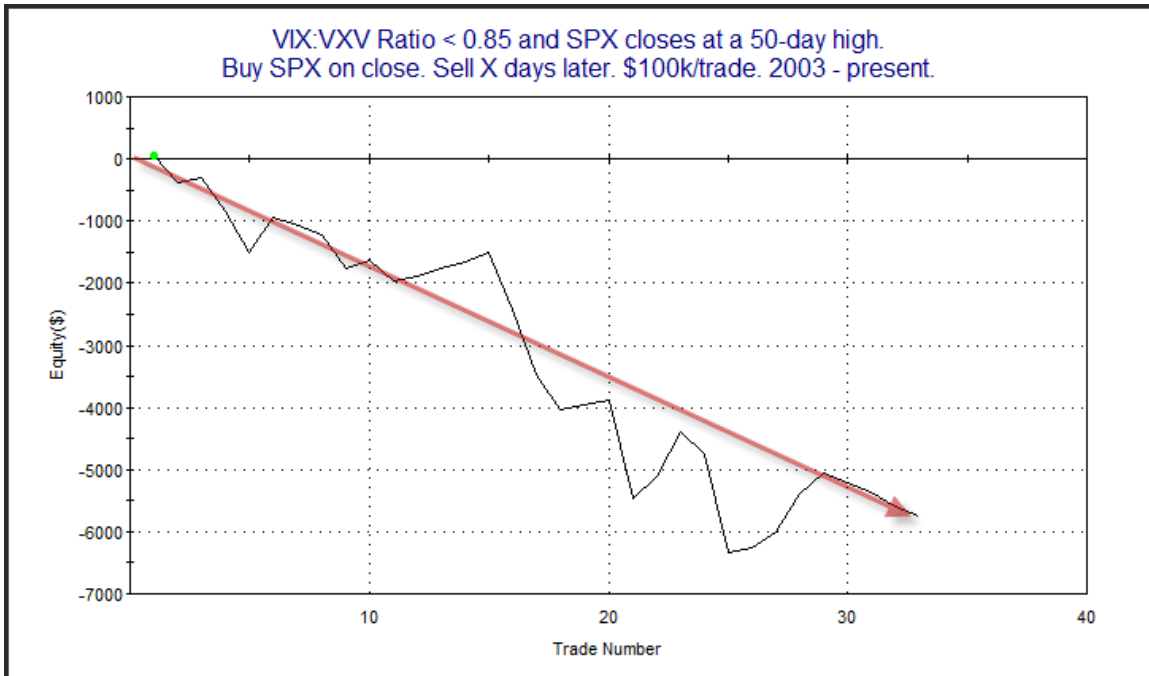
The Evidence

The persistent move higher continued on Thursday. The market opened near its lows and closed near its highs. In the end the SPX and Russell 2000 rose 0.4% while the NASDAQ was up 0.1%. Breadth was moderately positive as the NYSE Up Issues % came in at 61% and the Up Volume % was 62%. Total NYSE volume rose for the third day in a row.

The steady grind higher over the last few weeks has come with dampened volatility. This led the VIX to close at multiyear lows on Thursday. Short-term volatility expectations remain substantially below intermediate-term volatility expectations as exhibited by the VIX:VXV ratio, which dropped back under 0.85 on Thursday. Readings this low that have coincided with intermediate-term SPX highs have often been followed by short-term weakness. This is demonstrated in the study below, which last appeared in the 1/13/11 subscriber letter.

VIX:VXV Ratio < 0.85 and SPX closes at a 50-day high. Buy SPX on close. Sell X days later. \$100k/trade. 2003 - 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	-2,083.87	20	12	8	60.00	671.96	-1,268.42	0.53	0.79	-104.19
4	-4,373.89	21	9	12	42.86	573.57	-794.67	0.72	0.54	-208.28
3	-2,995.59	23	13	10	56.52	505.54	-956.76	0.53	0.69	-130.24
2	-4,494.93	25	9	16	36.00	545.99	-588.05	0.93	0.52	-179.80
1	-5,752.47	33	16	17	48.48	236.31	-560.79	0.42	0.40	-174.32

The stats suggest a mild downside inclination that plays out in the first day or two. Below is an equity curve that shows how the 1-day exit strategy has performed over time.



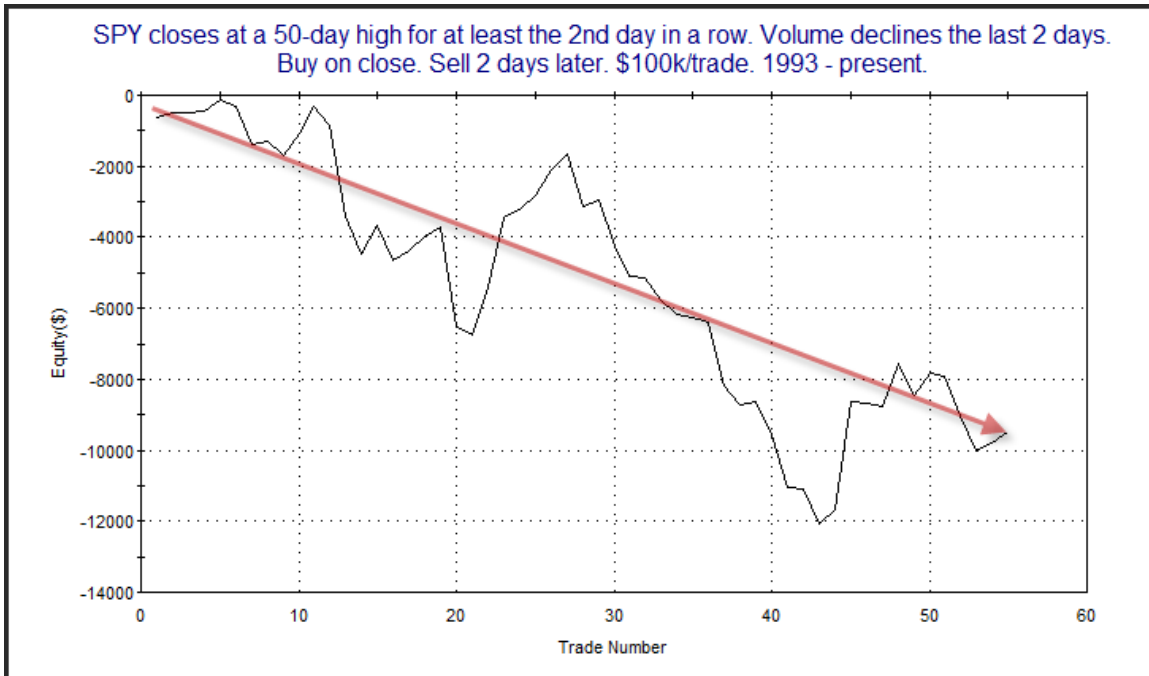
For a setup that takes place in an uptrend, the bearish inclinations appear fairly solid.

Volume action has been a bit odd the last few days as we have seen NYSE volume rise and SPY volume decline. This is an unusual situation and has led to mixed studies related to volume. In the 1/19/11 Subscriber Letter I showed a pattern that involved SPY price increases on declining volume. Inclinations appeared somewhat bearish. I have updated that study below.

SPY closes at a 50-day high for at least the 2nd day in a row. Volume declines the last 2 days.
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	-9,243.99	54	25	28	46.30	986.33	-1,210.80	0.81	0.73	-171.19
4	-8,273.27	55	26	29	47.27	834.27	-1,033.25	0.81	0.72	-150.42
3	-8,762.43	55	26	29	47.27	804.29	-1,023.24	0.79	0.70	-159.32
2	-9,496.97	55	24	31	43.64	621.37	-787.41	0.79	0.61	-172.67
1	-5,752.15	60	18	41	30.00	649.68	-425.52	1.53	0.67	-95.87

The stats here appear to suggest a moderate downside edge over the next 1-2 days. Below is an equity curve using a 20day exit strategy.



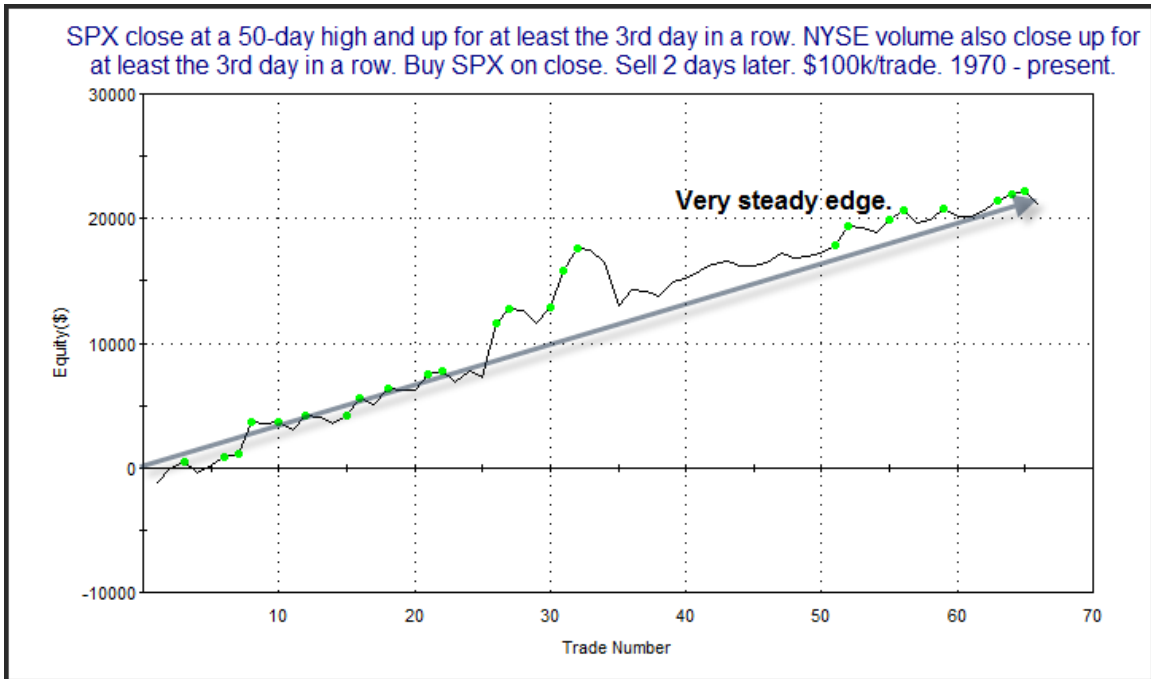
Definitely choppy but the series of lower highs and lower lows implies a downtrend intact.

But now let's look at the NYSE's INCREASING volume over the last 3 days. When the market rises to new highs and volume remains strong throughout that has often been a good sign. Below is a study that demonstrates this.

SPX close at a 50-day high and up for at least the 3rd day in a row. NYSE volume also close up for at least the 3rd day in a row. Buy SPX on close. Sell X days later. \$100k/trade. 1970 - 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	25,515.83	66	41	25	62.12	1,292.57	-1,099.19	1.18	1.93	386.60
4	12,645.03	66	40	26	60.61	1,026.15	-1,092.34	0.94	1.45	191.59
3	18,407.85	66	43	23	65.15	895.83	-874.47	1.02	1.92	278.91
2	21,014.56	66	40	26	60.61	927.16	-618.15	1.50	2.31	318.40
1	6,213.83	75	41	34	54.67	542.00	-470.83	1.15	1.39	82.85

The stats appear to suggest a short-term upside edge. Below is the equity curve using a 2-day exit strategy.



The curve here appears quite steady, confirming the upside inclination.

Since volume patterns aren't providing a clear edge I've elected to ignore both of the volume-related studies tonight. If they were to stand alone, then I would consider using either of them in the Aggregator. Since they are both triggering I believe it is best to just ignore them.

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



Very little change can be seen tonight with the Aggregator readings. 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 is still 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 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 Friday. This could change if more bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,350.66. This is about 0.7% below Thursday's close. In order for the Differential line to turn positive the SPX would need to close lower by at least this much.

The story remains much the same as the last few days. Overall, the studies continue to suggest the rally is likely to continue. This is despite the fact that the market is already short-term overbought. Markets like the current one that chug higher without so much as pausing can be frustrating. Most of my (long) strategies rely on buying dips and selling into rallies. It's difficult to watch the market rally when I have only moderate exposure and my expectations are bullish. For my Aggregator-type trades I've found patience has been rewarded much of the time over the years. And though I sometimes miss out on a strong run, it's worth avoiding the whipsaws that often occur. Some systems, like 90609,

will allow me to ride the trend until it appears to be over. So when the market has been in a basing period for a while like it was a couple of weeks ago, I become more inclined to take 90609 type trades like the one in EPP that I've been tracking.

In any case, I am not looking to add more exposure tonight.

VIX-based System Note

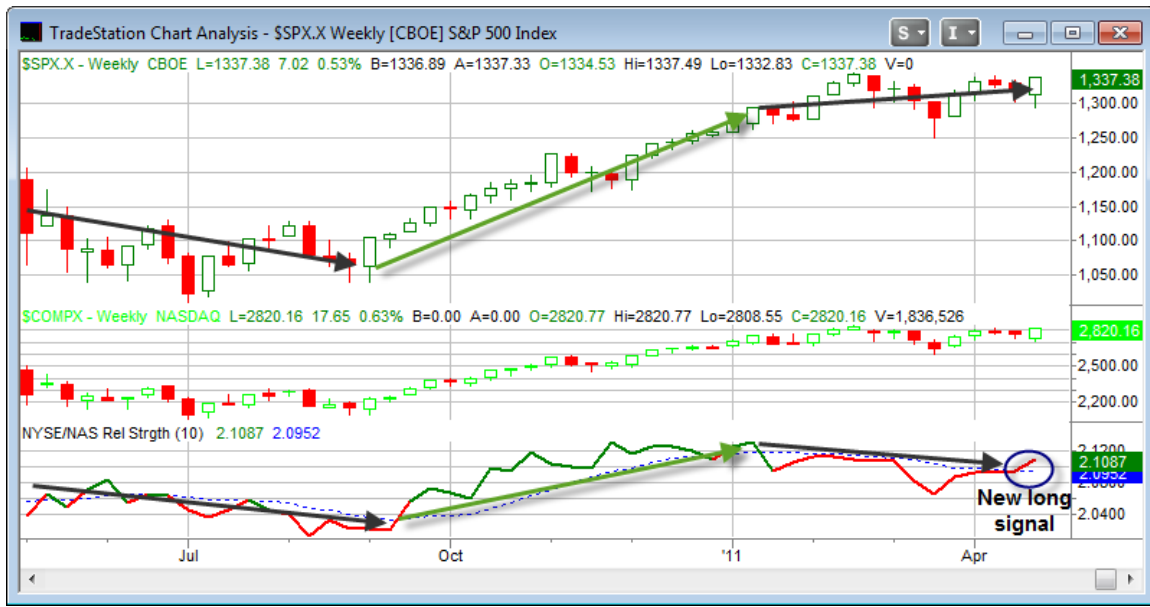
Since my presentation last month on VIX-based ETFs ([see videos page on website](#)) I've been especially watchful of the action in those securities. I've been trading small positions in them to get a better feel. Additionally, I have conducted a bit more research focused on creating a system that could take advantage of Aggregator-based edges combined with contango/backwardation. Next week I will hold another webinar on the subject in which I will share my thinking and provide an outline for a system that I will monitor based on these concepts. I received some valuable ideas from subscribers during and after the last webinar. I will be open to further feedback and ideas from subscribers on the system before I begin officially tracking it. More details will follow in the next few days.

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>

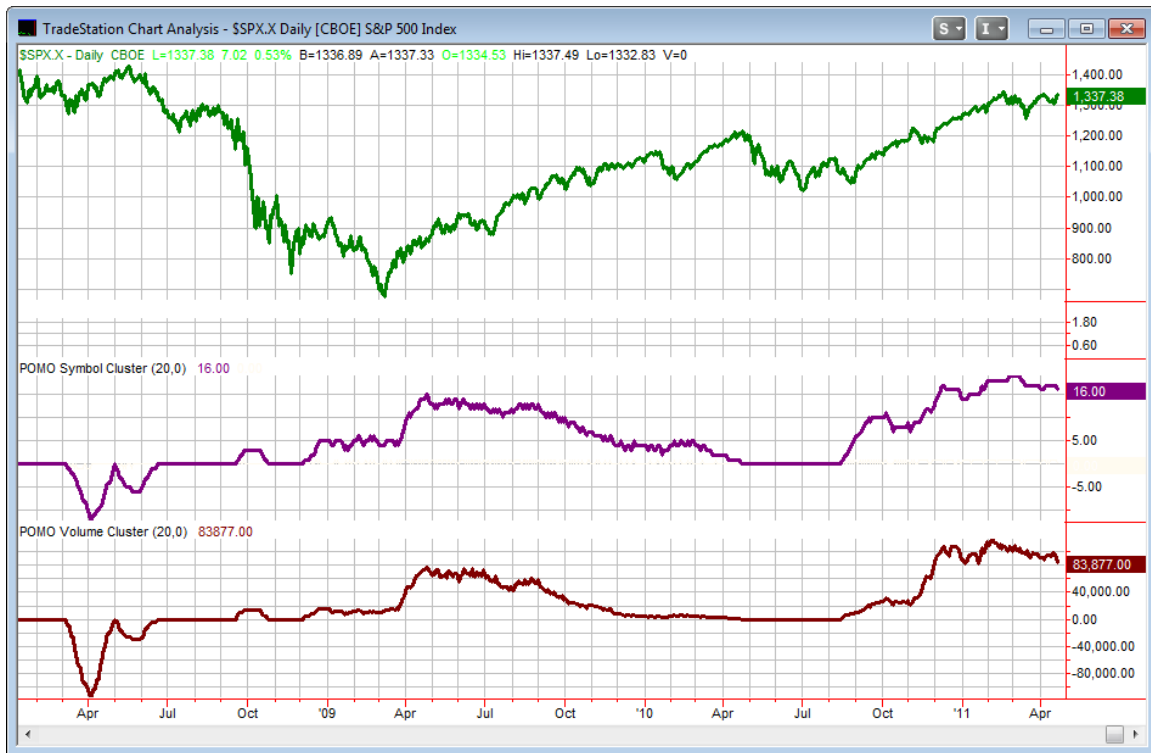


The basic idea is that the market tends to perform better when the Nasdaq leads the SPX. Historically, the SPX has made its money when the Nasdaq has been in leading position, and struggled to make headway when the Nasdaq has lagged. Looking at the action over the recent 11 months or so in the above 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 3rd 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 1st 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

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	\$50.92	4.24%		System 90609

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