

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 03, 2011

Volume 4 Issue 84

## Market Overview



## Tonight's Research Points

- Bearish engulfing days coming off highs have not been as bearish as advertised, often making new highs after a brief pullback.
- The strong underperformance by the Russell 2k suggests a rebound for the SPX.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is flat.

## *Short-term Outlook*

### *The Bottom Line*

The Aggregator is still neutral, but it appears to be nearing an entry point. A pullback on Tuesday could trigger the first new long signal in a while.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
May 3, 2011	Russell 2k drops much bigger	1-3 days	Bullish	1.70%
May 2, 2011	SPX up VIX up on Fri. SPX > 200ma.	1-2 days	Bearish	-1.05%
May 2, 2011	SPY highest close of month on last day	1-5 days	Bullish	2.40%
May 2, 2011	SPX > Upper BB 4 days	1-8 days	Bullish	1.90%
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%
<b>Active - Long Term</b>				
May 2, 2011	SPY up 3 days all lower volume	1-19 days	Bearish	
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	

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

## The Evidence

Osama Bin Ladin's death provided an overnight boost to futures, but the excitement wore off soon after the opening bell. When the day was done the major indices were mostly all lower. The SPX lost 0.2%, the Nasdaq dropped 0.3% and the Russell 2000 fell a much larger 1.2%. Breadth was negative as the NYSE Up Issues % came in at 41% and the Up Volume % was 39%. Total NYSE volume retreated for the 2<sup>nd</sup> day in a row.

Monday's action saw a new intraday high, an outside day, and a lower close. Engulfing reversal bars such as this are often viewed as bearish. I've looked at them a number of ways in the past. The study below is from the 9/15/10 Subscriber Letter.

After closing at a 10-day high SPY posts an outside day with a down close. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1994 - 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	57,260.38	41	33	8	80.49	2,401.05	-2,746.79	0.87	3.61	1,396.59
11	49,257.46	41	33	8	80.49	2,097.92	-2,496.74	0.84	3.47	1,201.40
10	41,342.21	42	32	9	76.19	1,856.57	-2,007.56	0.92	3.29	984.34
9	34,850.92	43	30	13	69.77	1,901.78	-1,707.88	1.11	2.57	810.49
8	41,701.62	44	30	14	68.18	2,101.66	-1,524.87	1.38	2.95	947.76
7	33,679.48	45	28	17	62.22	2,068.46	-1,425.74	1.45	2.39	748.43
6	32,025.09	46	30	16	65.22	1,827.32	-1,424.65	1.28	2.40	696.20
5	25,226.09	49	32	17	65.31	1,426.56	-1,201.40	1.19	2.24	514.82
4	6,031.43	49	26	23	53.06	1,386.58	-1,305.20	1.06	1.20	123.09
3	-7,228.99	49	24	25	48.98	1,103.69	-1,348.70	0.82	0.79	-147.53
2	-10,325.30	50	21	29	42.00	891.04	-1,001.28	0.89	0.64	-206.51
1	-7,400.43	50	25	25	50.00	562.99	-859.01	0.66	0.66	-148.01

Results here are similar to other studies I've run on outside day or key reversal bars. It is often followed by a few days of weakness but it rarely marks the kind of significant top it is renowned for.

Also notable about Monday's trading was the strong underperformance by the smallcaps. The next study examines this kind of action coming off a fresh SPX high. It was last seen in the 1/5/11 Letter and has been updated below.

SPX closed at a 20-day high yesterday. Today it closed down. The Russell 2000 closed down at least 1% more than the SPX. Buy SPX on close. Sell X days later. \$100k/trade. 1987 - 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
15	29,390.49	12	11	1	91.67	3,300.58	-6,915.92	0.48	5.25	2,449.21
14	26,696.35	13	9	4	69.23	3,730.94	-1,720.52	2.17	4.88	2,053.57
13	21,934.08	13	9	4	69.23	3,518.63	-2,433.40	1.45	3.25	1,687.24
12	20,854.92	13	10	3	76.92	2,727.23	-2,139.12	1.27	4.25	1,604.22
11	13,508.66	13	10	3	76.92	2,140.80	-2,633.12	0.81	2.71	1,039.13
10	14,571.21	14	11	3	78.57	1,943.04	-2,267.41	0.86	3.14	1,040.80
9	25,232.36	15	11	4	73.33	2,657.10	-998.93	2.66	7.31	1,682.16
8	24,811.24	15	13	2	86.67	2,156.28	-1,610.18	1.34	8.70	1,654.08
7	22,758.26	15	13	2	86.67	2,098.41	-2,260.54	0.93	6.03	1,517.22
6	12,726.72	15	13	2	86.67	1,501.55	-3,396.69	0.44	2.87	848.45
5	8,195.16	15	10	5	66.67	1,608.82	-1,578.62	1.02	2.04	546.34
4	7,601.24	16	9	7	56.25	2,105.44	-1,621.10	1.30	1.67	475.08
3	13,379.81	18	11	7	61.11	1,946.02	-1,146.63	1.70	2.67	743.32
2	5,315.34	18	12	6	66.67	1,349.19	-1,812.49	0.74	1.49	295.30
1	-2,809.58	18	10	8	55.56	1,169.26	-1,812.77	0.65	0.81	-156.09

It appears the sharp drop and underperformance by the Russell 2000 may be short-term bullish. Perhaps this is a case of a downside overreaction in an uptrending market. To get a better feel for the results I have listed all 13 instances below using the 7-day exit strategy.

SPX closed at a 20-day high yesterday. Today it closed down.  
 The Russell 2000 closed down at least 1% more than the SPX.  
 Buy SPX on close. Sell X days later. \$100k/trade. 1987 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
03/20/00	Buy	\$1,456.69	3.56%	\$6,540.24
03/29/00	Sell	\$1,508.52		(\$722.84)
05/16/03	Buy	\$944.30	0.94%	\$1,584.45
05/28/03	Sell	\$953.22		(\$3,386.25)
12/15/03	Buy	\$1,068.04	2.43%	\$2,688.63
12/24/03	Sell	\$1,094.04		\$0.00
06/03/04	Buy	\$1,116.63	1.38%	\$2,273.95
06/15/04	Sell	\$1,132.00		\$0.00
09/06/06	Buy	\$1,300.26	1.51%	\$1,853.64
09/15/06	Sell	\$1,319.87		(\$709.08)
12/18/06	Buy	\$1,422.48	0.16%	\$459.90
12/28/06	Sell	\$1,424.73		(\$854.00)
03/24/09	Buy	\$806.34	3.48%	\$4,869.48
04/02/09	Sell	\$834.38		(\$3,289.72)
04/06/09	Buy	\$835.48	3.57%	\$4,149.53
04/16/09	Sell	\$865.30		(\$2,493.05)
04/20/09	Buy	\$832.39	4.96%	\$5,960.40
04/29/09	Sell	\$873.64		(\$667.20)
05/07/09	Buy	\$907.39	0.26%	\$2,505.80
05/18/09	Sell	\$909.71		(\$3,129.50)
08/14/09	Buy	\$1,004.09	2.38%	\$3,332.34
08/25/09	Sell	\$1,028.00		(\$2,532.42)
11/12/09	Buy	\$1,087.24	1.75%	\$2,406.95
11/23/09	Sell	\$1,106.24		(\$173.81)
08/05/10	Buy	\$1,125.81	(4.12%)	\$301.84
08/16/10	Sell	\$1,079.38		(\$4,956.16)
01/04/11	Buy	\$1,270.20	1.07%	\$1,300.26
01/13/11	Sell	\$1,283.76		(\$663.00)
01/19/11	Buy	\$1,281.92	(0.44%)	\$1,618.50
01/28/11	Sell	\$1,276.34		(\$831.48)

There have been several instances over the last couple of years. One encouraging sign is that the results are fairly steady and the returns are not due to one or two outliers.

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



Positive studies continue to rule. The green Aggregator line ticked up a bit more 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 now just slightly 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 Tuesday. This could change if more bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,364.37. This is about 0.25% *above* Monday's close. The means that unless the SPX closes up at least this much, then the Differential line will turn positive and the Aggregator System will likely trigger long.

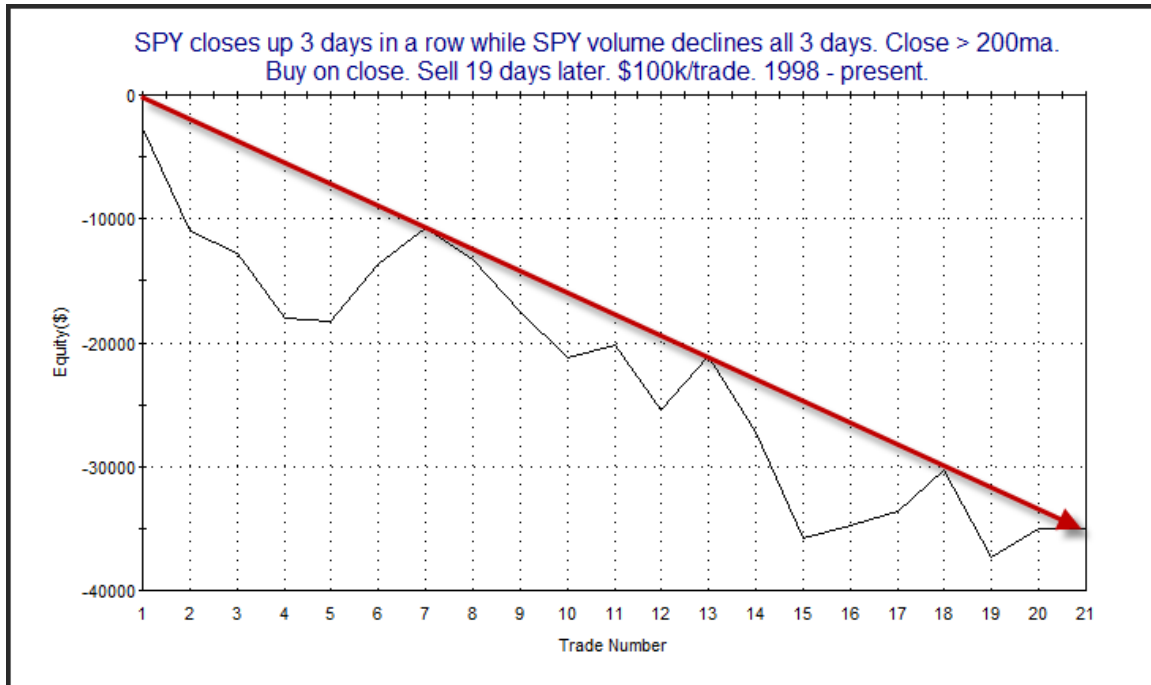
I've been waiting for a dip or a pause meaningful enough to get long. We may be nearing that point. Aggressive traders could look to enter near the end of the day tomorrow if it looks like the Aggregator is going to signal a long. I'll be monitoring action closely but won't be looking to add new trade ideas until tomorrow's letter after I can more thoroughly examine any studies that trigger.

**Intermediate-term Outlook (2 weeks – 2 months)– updated 5/2 – bullish**

The market pushed to new multi-year highs this week for the 1<sup>st</sup> time since February. And though most indications remain bullish, there was one study that appeared on Friday with possible intermediate-term bearish inclinations. That study looked at the rise in SPY on declining volume each of the last 3 days. It was last seen in the 12/6/10 Subscriber Letter. I have updated the results table below.

SPY closes up 3 days in a row while SPY volume declines all 3 days. 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
20	-22,558.69	21	9	12	42.86	2,665.54	-3,879.04	0.69	0.52	-1,074.22
19	-35,044.91	21	9	12	42.86	2,305.93	-4,649.86	0.50	0.37	-1,668.81
18	-28,940.74	22	8	14	36.36	2,737.98	-3,631.76	0.75	0.43	-1,315.49
17	-27,243.43	22	9	13	40.91	2,285.86	-3,678.17	0.62	0.43	-1,238.34
16	-22,301.47	22	10	12	45.45	2,286.36	-3,763.76	0.61	0.51	-1,013.70
15	-27,780.26	22	10	12	45.45	2,121.78	-4,083.17	0.52	0.43	-1,262.74
14	-25,054.18	23	9	14	39.13	2,056.01	-3,111.31	0.66	0.42	-1,089.31
13	-20,210.83	24	12	12	50.00	1,508.80	-3,193.04	0.47	0.47	-842.12
12	-15,982.33	24	12	12	50.00	1,443.72	-2,775.59	0.52	0.52	-665.93
11	-13,402.40	24	12	12	50.00	1,585.78	-2,702.65	0.59	0.59	-558.43
10	-14,720.22	24	14	10	58.33	1,640.42	-3,768.61	0.44	0.61	-613.34
9	-14,787.19	24	13	11	54.17	1,567.45	-3,196.73	0.49	0.58	-616.13
8	-9,081.91	24	14	10	58.33	1,506.67	-3,017.53	0.50	0.70	-378.41
7	-3,062.45	25	16	9	64.00	1,503.71	-3,013.54	0.50	0.89	-122.50
6	-8,125.62	25	14	11	56.00	1,365.52	-2,476.62	0.55	0.70	-325.02
5	-17,916.26	26	14	12	53.85	1,030.28	-2,695.01	0.38	0.45	-689.09
4	-7,609.94	27	15	11	55.56	963.36	-2,005.48	0.48	0.66	-281.85
3	-5,068.15	27	15	12	55.56	820.69	-1,448.21	0.57	0.71	-187.71
2	-633.18	27	14	13	51.85	860.16	-975.03	0.88	0.95	-23.45
1	-2,353.08	29	14	15	48.28	550.12	-670.31	0.82	0.77	-81.14

There doesn't appear to be an overwhelming edge based on the data but it does hint at poor risk/reward for the intermediate-term. Below is an equity curve using a 19-day holding period.

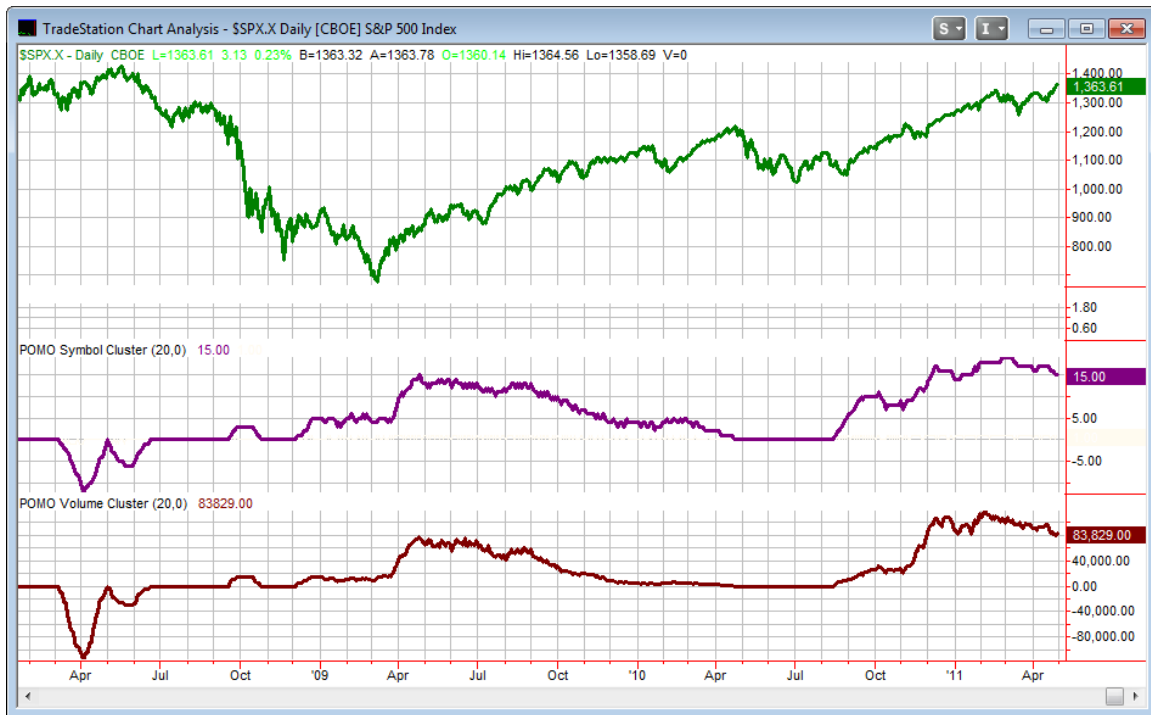


Though choppy, this would seem to support the bearish case. I believe it's worth listing and monitoring this study on the Intermediate-term Active List.

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 pulled back a little more this past week. The days indicator is at 15 and the POMO Volume indicator is down near the low end of its recent range. The schedule calls for POMO buying for the next 8 trading days, and then a new schedule to be released on the 8<sup>th</sup> day. I therefore expect we will see the POMO Days and POMO Volume indicators will get a boost over the next week and a half (and likely longer). I expect POMO to continue to act as a wind at the markets back. The new schedule to be released in a week and a half should be interesting. It will take us through the first 1/3 of June. June is when the QE2 POMO buying is scheduled to end, so we will see if there are any indications of that in the next schedule release.

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)

Bullish studies continue to dominate and the market is now making new highs. This is not a situation in which I would become an aggressive short seller. Instead I will look for long opportunities that I can play aggressively, and nibble on the short-side should short-term evidence switch to favor the bears.

## **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	\$50.53	3.44%		System 90609

Being that 90609 uses a trend-following exit technique, EPP is nowhere near an exit at the moment.

This report has been prepared by Hanna Capital Management, LLC and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy securities. While information contained herein is believed to be accurate at the time of publication, we make no representation as to the accuracy or completeness of any data, studies, or opinions expressed and it should not be relied upon as such. Robert Hanna, Hanna Capital Management, LLC or clients of Hanna Capital Management, LLC may have positions or other interests in securities (including derivatives) directly or indirectly which are the subject of this report. This report is provided solely for the information of Hanna Capital Management, LLC clients and prospects who are expected to make their own investment decisions without reliance upon this report. Neither Hanna Capital Management, LLC nor any officer or employee of Hanna Capital Management, LLC accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report may not be reproduced, distributed or published by any recipient for any purpose without the prior express consent of Hanna Capital Management, LLC.

Copyright © 2011 Hanna Capital Management, LLC.