

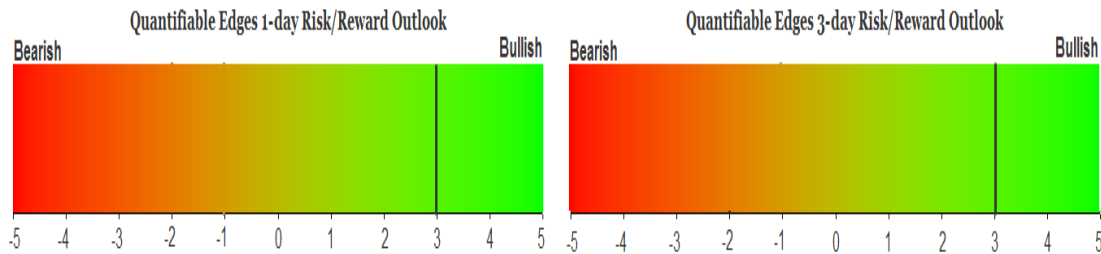
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 04, 2011

Volume 4 Issue 85

## Market Overview



## Tonight's Research Points

- The 2-day pullback into the recent range is not triggering much in the way of new edges.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is long.

## *Short-term Outlook*

### *The Bottom Line*

Risk/reward now seems to be favoring the bull case. I'm looking to start building a long index position.

## *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	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%
<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	
<b>Dropped Tonight</b>				
May 2, 2011	SPX up VIX up on Fri. SPX > 200ma	1-2 days	Bearish	-1.05%
April 27, 2011	Unfilled gap to new 50-day high	1-5 days	Bullish	1.70%

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

## *The Evidence*

Tuesday started off weak and never put in much of an attempt to rally. Instead it spent most of the day chopping around in negative territory. When it was over the SPX had lost 0.3%, the NASDAQ was down 0.8%, and the Russell 2000 was the big loser for the second day in a row with a 1.3% loss. Breadth was weak as the NYSE Up Issues % came in at 35% and the Up Volume % was 40%. Total NYSE volume rose to the highest level in a couple of weeks.

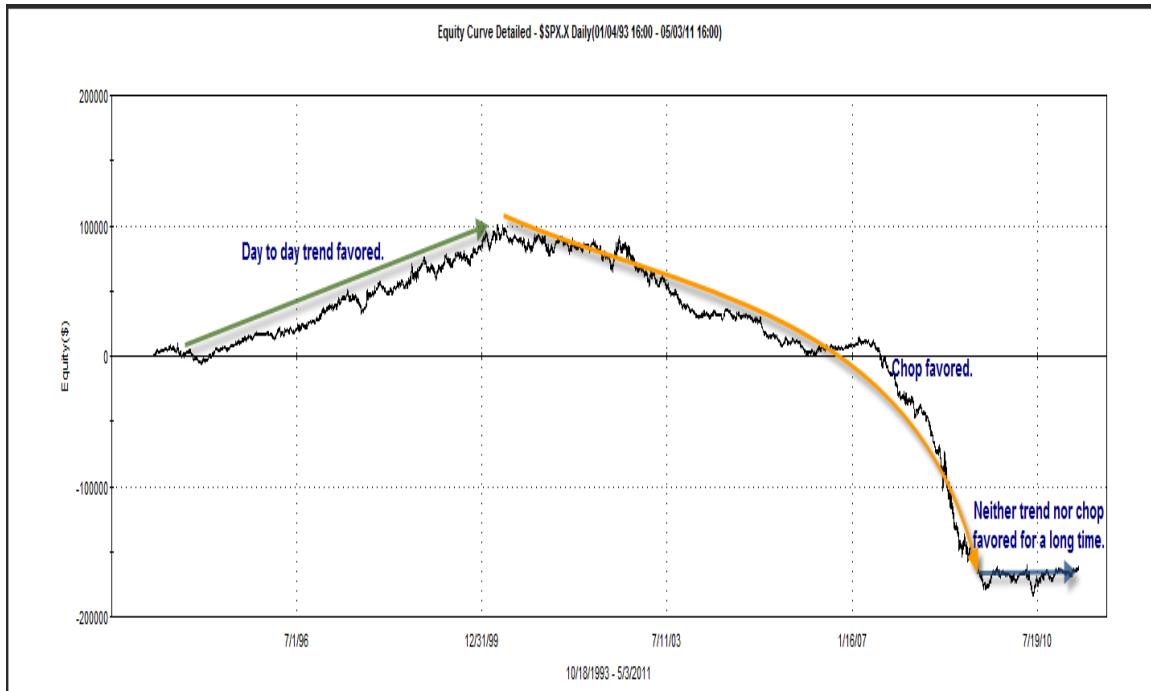
The Quantifinder came up with a rare blank tonight. This isn't terribly surprising considering the action the last couple of days. We have basically seen moderate declines over the last two days after reaching a new high on Friday. If the declines were steeper or if the pullback was longer in duration, then we would be more likely to see some studies trigger. It isn't long ago that a 2-day pullback would have incited some studies.

From 2007 through early 2009 the market was experiencing incredibly choppy action. Down days were frequently followed by up days and vice-versa. I discussed this in a blog post in August of 2008, which is linked below:

<http://quantifiableedges.blogspot.com/2008/08/how-to-trade-choppiest-environment-in.html>

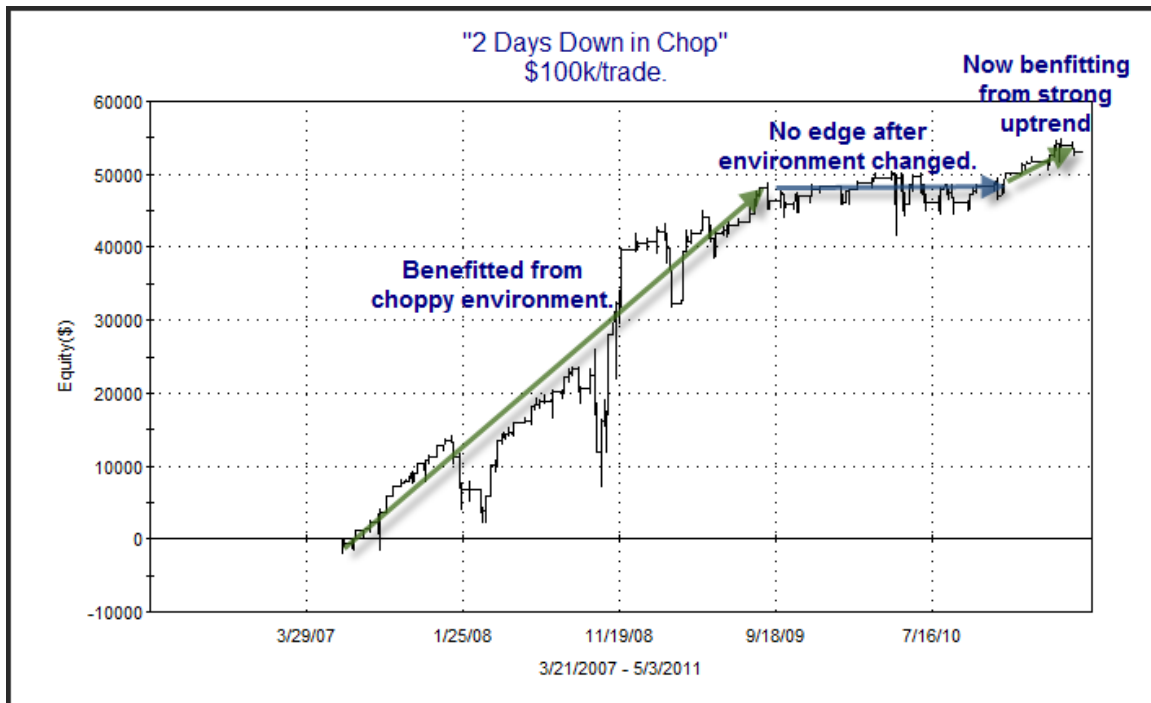
Shortly after this I published two simple systems which I used for monitoring the market - not for actual trading. I referred to them as "2 Days Down (Up) in Chop". The rules were simple. If the market moves in one direction for two days in a row, then take a position in the opposite direction. Exit that position on the first profitable close up to 3(4) days later. ([Click here for a link to the blog where I showed it all in more detail.](#)) Because the market environment was so choppy, these systems performed outstanding. In fact there was a period of time that they outperformed my own trading by such a substantial amount that I felt a little foolish for doing all the research I do. Of course simple systems like these don't last forever. They are not based on long-term market truths, but instead on environmental anomalies. When the environment changed in the summer of 2009 and the market no longer exhibited such strong day-to-day choppiness, these systems lost their effectiveness. I haven't mentioned them in about a year and a half, but thought it would be interesting to take a look again today. First I'll show a long-term

view of the Trend vs. Chop chart that was discussed in the blog post above and is updated weekly on the subscribers Charts page.



As you can see, the curve has now moved sideways for nearly 2 years. This means that neither chop nor follow-through has been favored. Systems designed to take advantage of either have likely struggled.

But we have been locked in a strong uptrend recently, so perhaps the “2 Days Down in Chop” strategy may have benefited from that. Below is the equity curve as it now looks.



It appears the “2 Days Down in Chop” strategy would have performed fairly well lately. It isn’t something I’d have much faith in without a highly choppy environment to aide it. Still, this is a reminder that while the “Trend vs. Chop” charts haven’t done anything exciting for nearly 2 years now, they are worth keeping an eye on. Should the environment become more prone to one or the other, simple systems like this can be used to take advantage. I’m continually keeping a close eye to see if such an environment emerges.

So no new studies were added to the Active list tonight, but the lone bearish study reached its target and 1 bullish study expired. There are now just bullish studies remaining active for the short-term.

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



With only bullish studies on the Short-Term Active List it's no surprise the green Aggregator line is 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 has also now moved above 0. Readings greater than 0 mean the SPX has underperformed expectations over the last few days. So net expectations are for upside and the SPX is relatively oversold. Historically this configuration has provided a bullish edge. It can be seen on the chart whenever both lines close above 0. Due to this the Aggregator System turned long at the close.

The green Aggregator line is again set to close above 0 on Wednesday. This could change if more bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,368.30. This is almost 0.9% above Tuesday's close. So for the Differential Line to cross back below 0 and signal the SPX is no longer oversold the SPX would need to close up at least this much.

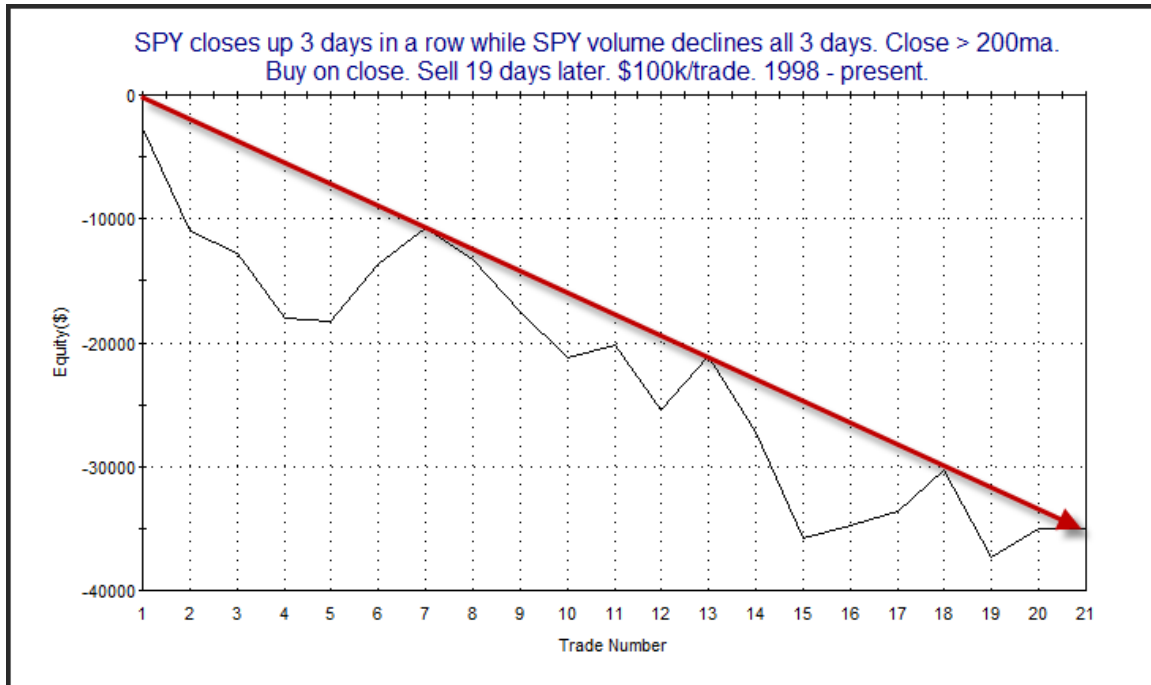
There are a good number of indications that the market should put in some gains over the next few days. This includes studies related to relative strength, momentum, and seasonality. I've been waiting for the overbought readings to wear off in order to enter at a point with less risk. The Aggregator is suggesting this may be a favorable entry point. Still, with the pullback still only very mild it could easily have further to go. Only a small fraction of the recent runup in the SPX has been retraced. So I'll start off by scaling in here as I often do, and I'll get more aggressive if it pulls back further and we continue to see bullish evidence emerge. Details in the Trade Ideas section below.

**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.

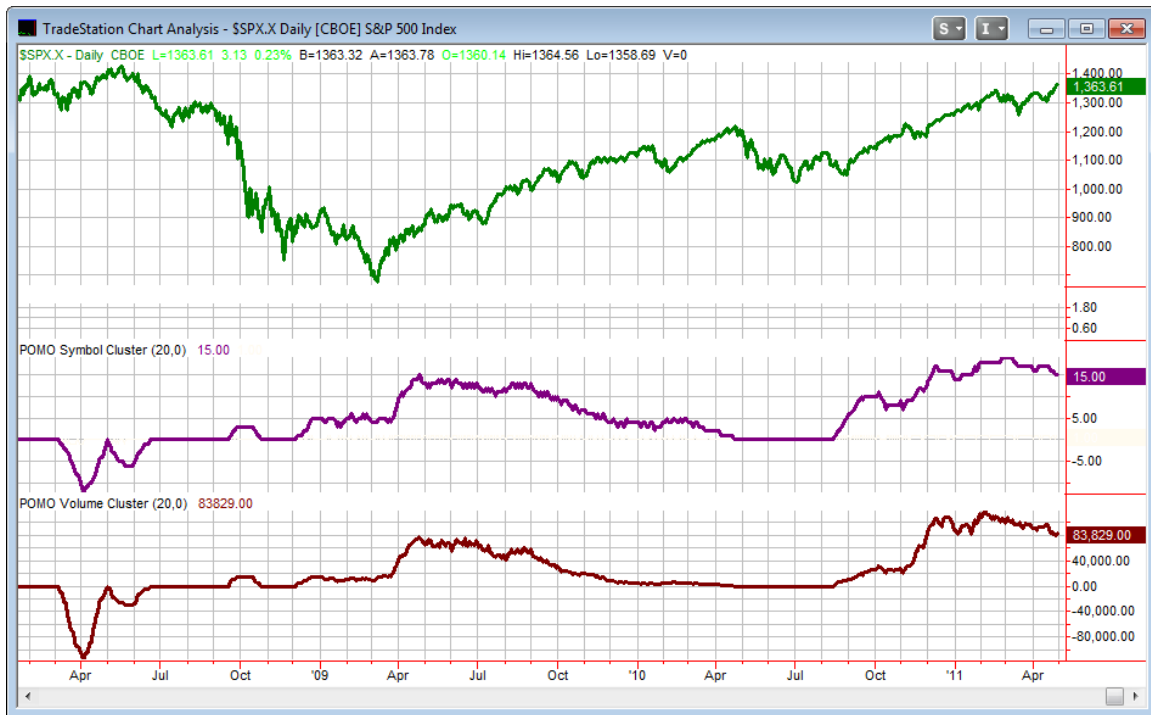


Though choppy, this would seem to support the bearish case. I believe it's worth listing and monitoring this study on the Intermediate-term Active List.

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.*

*SPY – buy ¼ index position @ \$135.73 limit. Based on short-term outlook above. I'm looking to start building a long position.*

### **Current Open Trade Ideas**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Price</b>	<b>% Gain/Loss</b>	<b>Stop</b>	<b>Notes</b>
EPP	4/19/2011	\$48.85	\$49.79	1.92%		System 90609

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

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