

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 05, 2011

Volume 4 Issue 86

Market Overview



Tonight's Research Points

- The 1st 5-day closing low in 2 weeks is normally good for a bounce.
- Action in the SPX and VIX is also hinting at a short-term upside edge.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is long.

Short-term Outlook

The Bottom Line

I'm long and looking to get longer.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
May 5, 2011	SPY 1st 5-day low in 10 days	1-4 days	Bullish	1.60%
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%
Active - Long Term				
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

It's been a tough month so far for May. While only three days old, the market has sold off all three days. Damage was again broad today as the major indices were all hit with selling. The SPX dropped 0.7%, the NASDAQ was down 0.5%, and the Russell 2000 again fell the most with another 1.3% drop. Breadth was very weak as the NYSE Up Issues % came in at 31% and the Up Volume % was just 26%. Total NYSE volume came in at the highest level since March.

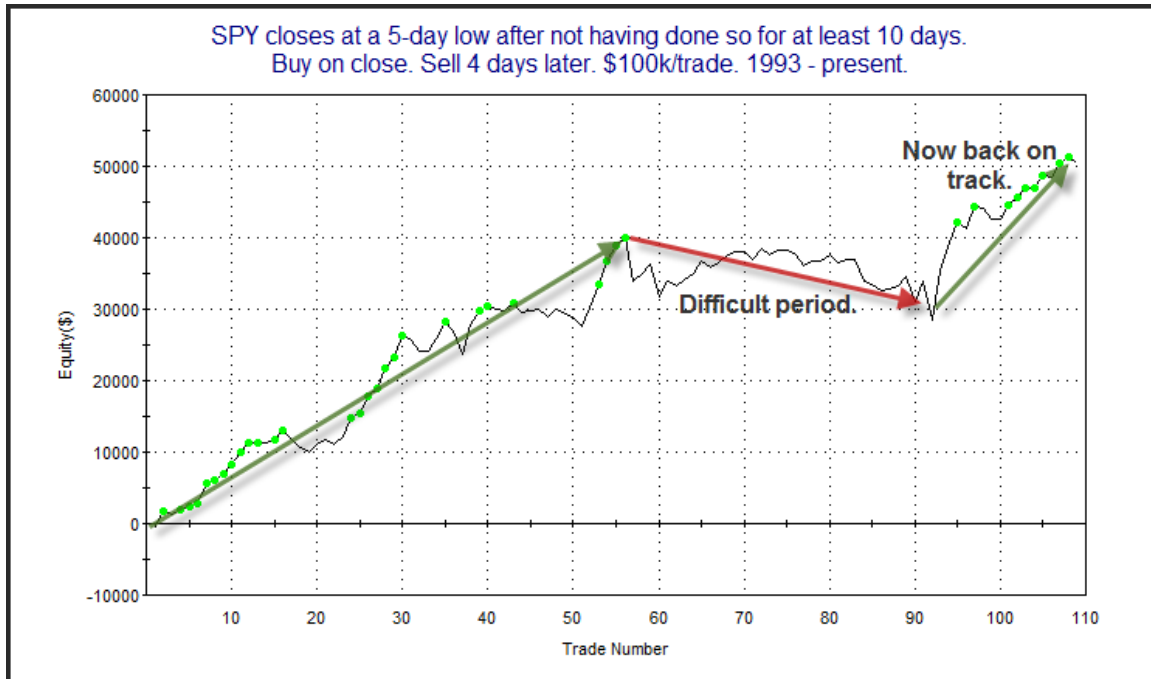
Despite the three day pullback not a lot showed up in the Quantifinder tonight. There were a few interesting things to look at though, so let's get to it.

In the 4/11/11 subscriber letter I showed a study that examined other times the SPY closed at a 5-day low for the first time in at least two weeks. I have updated that study below.

SPY closes at a 5-day low after not having done so for at least 10 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
10	78,575.25	109	72	37	66.06	2,129.98	-2,021.18	1.05	2.05	720.87
9	67,606.84	109	71	38	65.14	1,957.21	-1,877.76	1.04	1.95	620.25
8	62,736.20	109	71	37	65.14	1,866.22	-1,885.55	0.99	1.90	575.56
7	50,870.97	109	70	39	64.22	1,832.69	-1,985.06	0.92	1.66	466.71
6	40,602.96	109	67	42	61.47	1,700.77	-1,746.39	0.97	1.55	372.50
5	40,505.62	109	68	40	62.39	1,581.21	-1,675.42	0.94	1.60	371.61
4	50,368.84	109	70	39	64.22	1,465.67	-1,339.18	1.09	1.96	462.10
3	33,140.77	109	67	42	61.47	1,317.89	-1,313.29	1.00	1.60	304.04
2	21,141.36	109	61	47	55.96	1,118.17	-1,001.43	1.12	1.45	193.96
1	12,935.78	109	62	47	56.88	845.55	-840.18	1.01	1.33	118.68

95 of 109 instances (87%) closed above the entry price at some point in the next week.

Results here seem to suggest a moderate upside edge. With the 4-day exit appearing to be compelling from a % Profitable, Avg Trade, and Profit Factor standpoint, I ran an equity curve with it.



After showing a pretty consistent upside edge for almost 60 instances, it chopped a bit (mostly due to bear markets). Over the last 15 trades or so the edge seems to have reasserted itself.

A 3-day pullback on its own doesn't provide much of an upside edge. An edge tends to appear when the pullback happens in conjunction with other things. "Other things" might include a very low 3/10 Offset HV, a deceleration in the pullback, or a seasonal advantage. None of those things are appearing right now. But I did note one interesting aspect of this pullback that seems worth further examination. While the SPX has declined the last three days, the VIX has risen the last three days. This isn't unusual. What is unusual is the fact that today's drop was the biggest for the SPX, yet the rise in the VIX was the smallest of the last 3 days. I looked at other times this had occurred since 1990.

SPX drops at least 3 days in a row while VIX rises at least 3 days in a row. Today is the biggest drop in 3 days for the SPX but the smallest rise in 3 days for the VIX.
Buy SPX on close. Sell X days later. \$100k/trade. 1990 - 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	12,281.97	12	6	6	50.00	3,392.28	-1,345.29	2.52	2.52	1,023.50
4	12,255.73	12	6	6	50.00	3,195.88	-1,153.25	2.77	2.77	1,021.31
3	12,897.11	12	8	4	66.67	2,518.56	-1,812.84	1.39	2.78	1,074.76
2	8,735.20	12	9	3	75.00	1,857.85	-2,661.82	0.70	2.09	727.93
1	5,144.88	12	9	3	75.00	804.06	-697.23	1.15	3.46	428.74

11 of 12 instances posted a close above the entry price on at least 1 of the next 2 days.

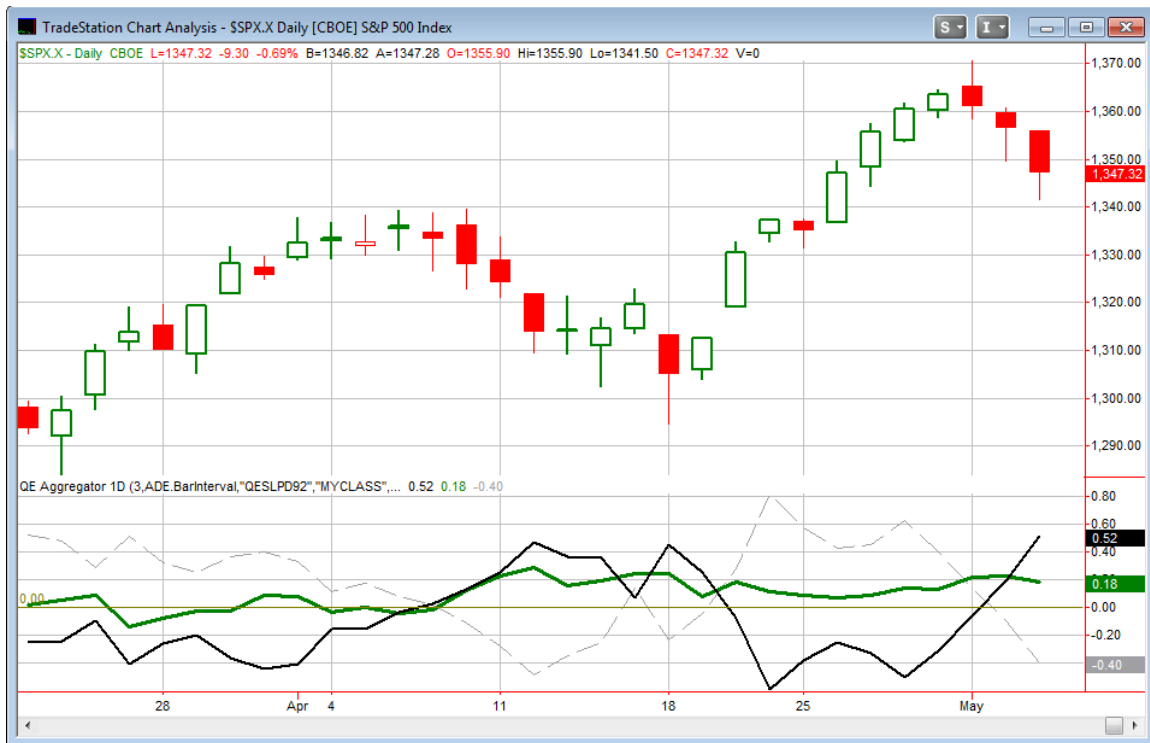
Not a whole lot of instances but early indications are that the setup may be bullish. Below is a list of all the instances using a 2-day exit strategy.

SPX drops at least 3 days in a row while VIX rises at least 3 days in a row. Today is the biggest drop for the SPX but the smallest rise for the VIX.
Buy SPX on close. Sell X days later. \$100k/trade. 1990 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
06/07/91	Buy	\$379.42	0.43%	\$578.60
06/11/91	Sell	\$381.05		(\$389.24)
02/09/93	Buy	\$445.33	0.52%	\$902.72
02/11/93	Sell	\$447.65		(\$246.40)
06/21/94	Buy	\$451.34	(0.38%)	\$623.22
06/23/94	Sell	\$449.63		(\$422.11)
11/14/95	Buy	\$589.29	1.37%	\$1,456.78
11/16/95	Sell	\$597.34		(\$157.17)
03/13/97	Buy	\$789.56	0.78%	\$922.32
03/17/97	Sell	\$795.71		(\$829.08)
04/25/97	Buy	\$765.37	3.75%	\$3,779.10
04/29/97	Sell	\$794.05		(\$269.10)
09/15/99	Buy	\$1,317.97	1.32%	\$1,467.75
09/17/99	Sell	\$1,335.42		(\$1,351.50)
11/30/99	Buy	\$1,389.07	1.44%	\$1,417.87
12/02/99	Sell	\$1,409.04		(\$119.99)
04/12/00	Buy	\$1,467.19	(7.58%)	\$702.44
04/14/00	Sell	\$1,356.02		(\$8,689.72)
09/26/00	Buy	\$1,427.34	2.17%	\$2,404.50
09/28/00	Sell	\$1,458.25		(\$553.00)
08/05/02	Buy	\$834.60	5.05%	\$5,252.66
08/07/02	Sell	\$876.77		\$0.00
11/18/03	Buy	\$1,034.15	(0.05%)	\$1,183.68
11/20/03	Sell	\$1,033.65		(\$70.08)

I tossed around whether to include this study on the Active List or not. Ultimately I decided not to. The results were very variable, the number of instances was low, and the last time it occurred was 2003. I will continue to monitor it going forward, though.

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



The Short-Term Active List remains void of bearish studies, leaving the green Aggregator line 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 continues to climb farther 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 strongly oversold versus recent expectations. 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 remained long at the close.

The green Aggregator line is again set to close above 0 on Thursday. This could change if strong bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,367.56. This is 1.5% above Wednesday'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 put in a very strong day on Thursday. In all likelihood the long signal will remain in place another day.

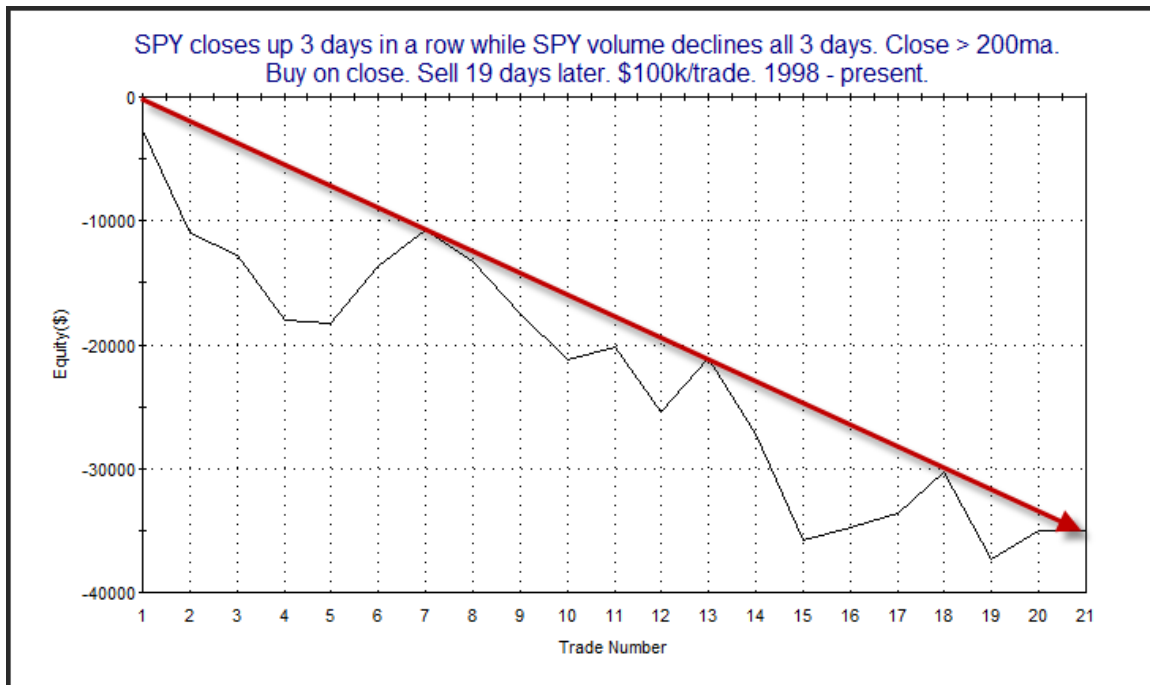
Bottom line is there appears to be a short-term upside edge. Evidence isn't overwhelming but it is solid. I began building a position in the Trade Ideas section on Wednesday. Wednesday was a good example of why I often like to scale in rather than take on a full position right off the bat – especially without overwhelming evidence or a very strong oversold reading as I discussed last night. I will look to add to my position Thursday and have provided 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 1st 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.

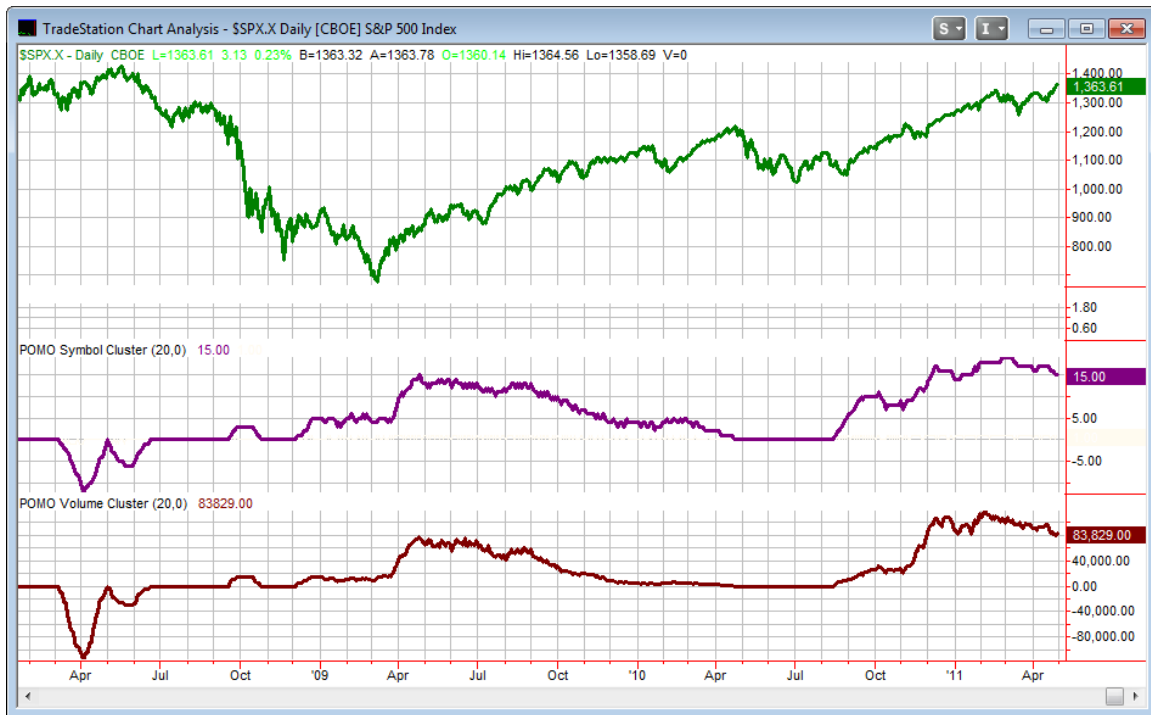


Though choppy, this would seem to support the bearish case. I believe it's worth listing and monitoring this study on the Intermediate-term Active List.

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 3rd 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 8th 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

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 1/4 index position @ \$134.83 limit. Based on short-term outlook above. I'm going to scale in a bit more.

SPY – buy 1/4 index position @ \$133.70 LIMIT ON CLOSE. A move down to here would put us near the lower end of the range since the 4/20 gap up and also near the early April congestion area. In other words, we could find some support there and it is a reasonable place for a bounce. I'll wait for the end of the day to enter though so as not to jump into 2 lots in the middle of a strong intraday selloff.

Those looking to trade something other than SPY can check out the triggers page tonight. There are quite a few stocks and ETFs set up with system 11111.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
EPP	4/19/2011	\$48.85	\$48.64	-0.43%		System 90609
SPY	5/4/2011	\$135.67	\$134.83	-0.62%		bought on open

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