

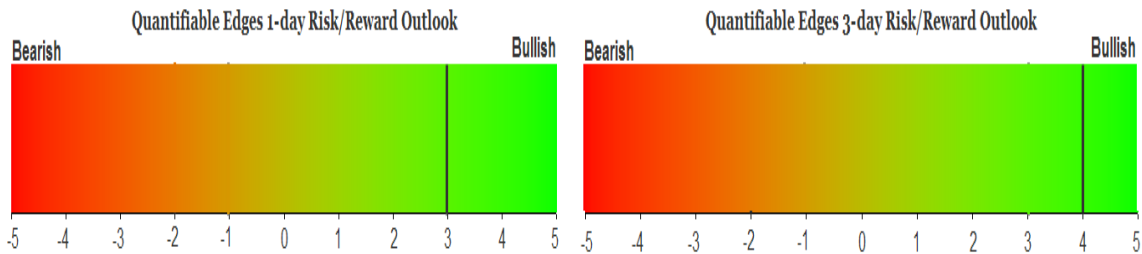
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 09, 2011

Volume 4 Issue 88

## Market Overview



## Tonight's Research Points

- Despite the Friday's modest gains, the pattern suggest further short-term gains.
- A rise in the VIX along with the SPX on a Friday is often followed by selling.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is long.

## *Short-term Outlook*

### *The Bottom Line*

The bounce on Friday wasn't as strong as anticipated, but indications remain positive and there appears to be more room for this market to bounce.

## *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 9, 2011	Down 4 days. Then weak bounce	1 day	Bullish	
May 9, 2011	VIX up. SPX up on Fri.	1-3 days	Bearish	-1.30%
May 6, 2011	Down 4 days. Today's is the worst.	1-5 days	Bullish	2.10%
May 5, 2011	SPY 1st 5-day low in 10 days	1-4 days	Bullish	1.60%
May 2, 2011	SPX > Upper BB 4 days	1-8 days	Bullish	1.90%
<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	
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	SPY highest close of month on last day	1-5 days	Bullish	2.40%
April 11, 2011	QQQ 5 lower lows. Today worst day.	1-20 days	Bullish	13.00%

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

## The Evidence

A positive reaction to the employment report sparked a strong morning rally, but it pooped out a little before 11:30 EST. From there it was mostly a drift lower. In the end the indices managed to hold on to some gains, but compared to early morning the results were somewhat disappointing. The SPX finished up 0.4% while the Nasdaq and Russell 2000 each gained 0.5%. Breadth was solidly positive as the NYSE Up Issues % came in at 66% and the Up Volume % was 69%. Total NYSE volume dipped just a little from Thursday's high level.

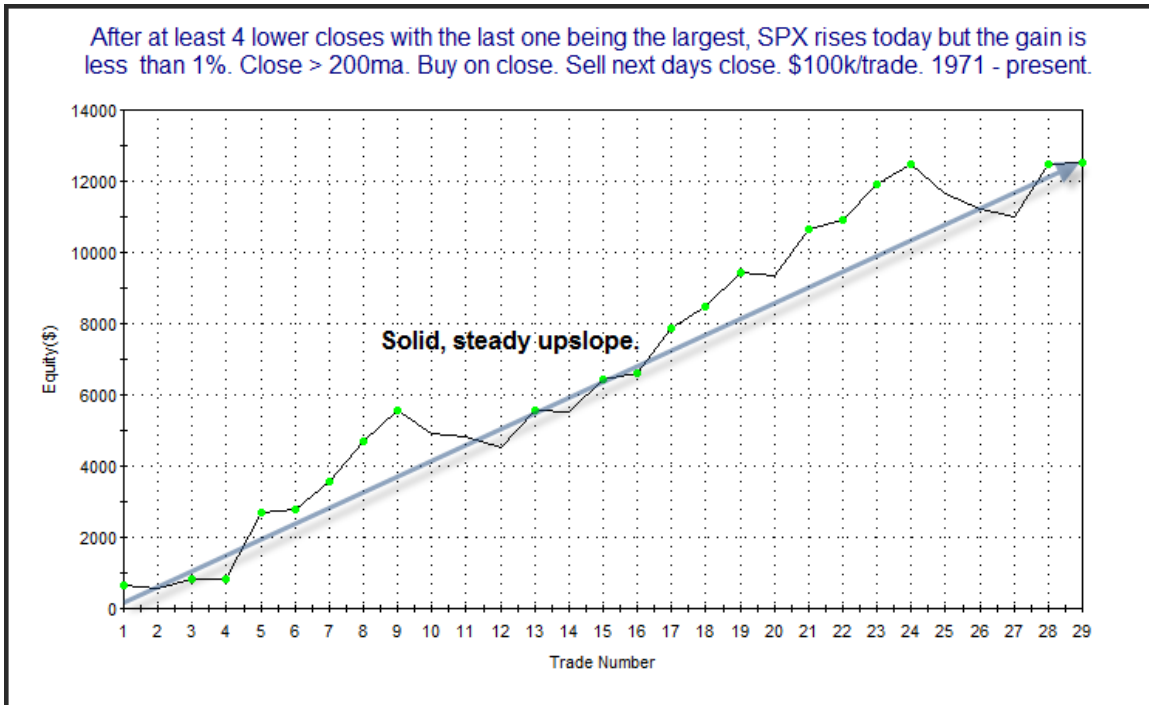
So I was looking for the market to bounce, and it did, but not to the degree that was expected. How a market bounce begins after the market reaches strongly oversold levels will often provide clues to the success chances of that bounce. Strong bounces are typically more prone to follow through and weak bounces sometimes suggest trouble. That isn't always the case, though. And despite my efforts I couldn't find much evidence to suggest this bounce was acting in a way that would signal immediate trouble.

A few studies were triggered by the Quantifinder which suggested very mild upside expectations based on the current pattern. The most compelling was one I showed just a couple of weeks ago in the 4/14/11 Subscriber Letter. It looked at bounces after 4+ down days and a relatively large selloff on the last day. I took that study and filtered further using the 200ma. The new study is shown below.

After at least 4 lower closes with the last one being the largest, SPX rises today but the gain is less than 1%. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1971 - 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	15,604.11	29	19	10	65.52	1,318.74	-945.20	1.40	2.65	538.07
4	14,181.87	29	20	9	68.97	997.91	-641.81	1.55	3.46	489.03
3	9,135.66	29	18	11	62.07	1,010.78	-823.50	1.23	2.01	315.02
2	10,329.11	29	18	11	62.07	1,004.48	-704.68	1.43	2.33	356.18
1	12,507.21	29	20	9	68.97	765.95	-312.43	2.45	5.45	431.28

**25 of 29 instances (86%) closed above the entry price at some point in the next 3 days.**

Over the 1-5 day period there appears to be a bit of an upside edge. Most of the gains are typically realized on day 1 though. Below is an equity curve showing a 1-day holding period.



This is an attractive looking curve and it acts as confirmation of the bullish edge.

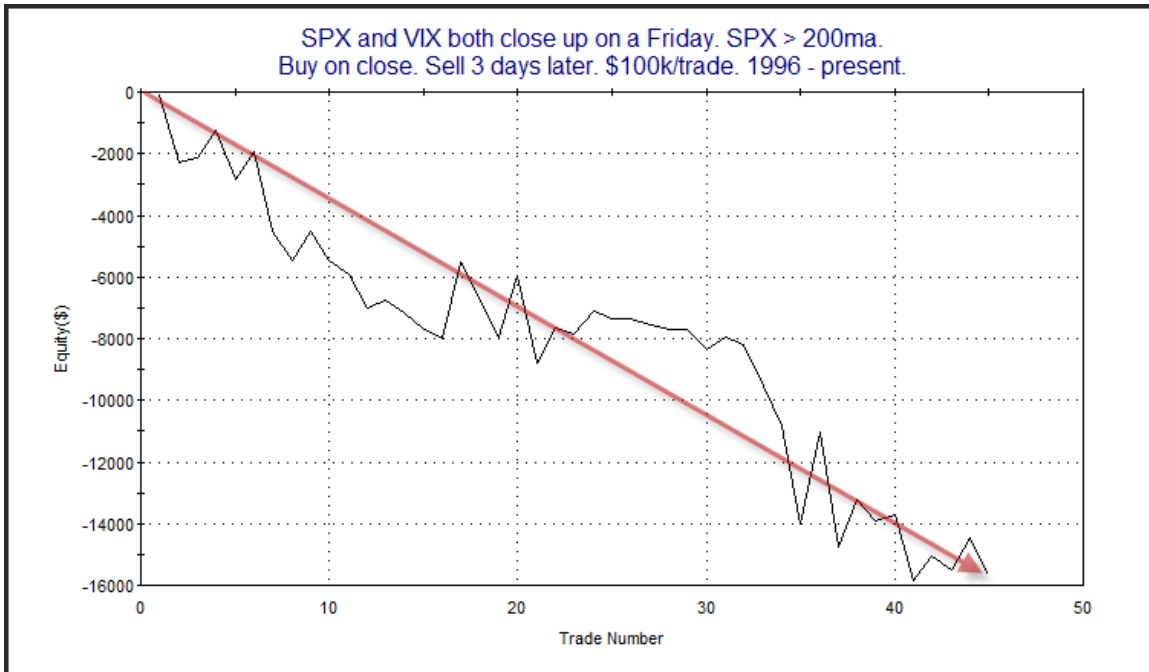
There was one Quantifinder study that appeared on Friday that suggested a bearish edge. It was based on the fact that the VIX rose along with the SPX on Friday.

SPX and VIX both close up on a Friday. SPX > 200ma.  
Buy 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	-10,688.35	44	18	26	40.91	1,530.02	-1,470.34	1.04	0.72	-242.92
4	-16,442.61	45	18	27	40.00	1,140.30	-1,369.19	0.83	0.56	-365.39
3	-15,655.29	45	16	29	35.56	1,025.32	-1,105.53	0.93	0.51	-347.90
2	-14,471.52	45	17	28	37.78	800.54	-1,002.88	0.80	0.48	-321.59
1	-10,996.15	45	13	32	28.89	516.35	-553.40	0.93	0.38	-244.36

42 of 45 instances (93%) closed below the entry price at some point in the next week.

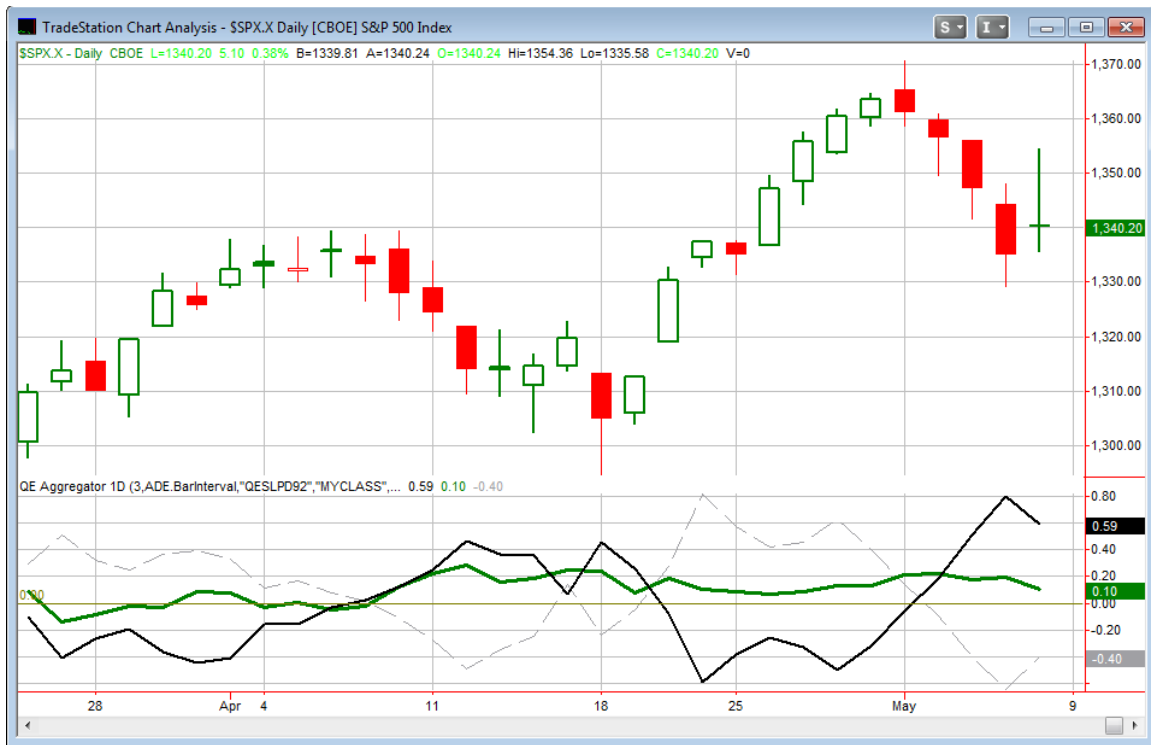
The stats here seem to suggest a downside edge over the 1-3 day period. Below is an equity curve using a 3-day hold.



So there is some conflict among studies tonight, with one suggesting a short-term upside edge and the other a short-term downside edge.

Of course it isn't terribly unusual that different studies may be taking opposing views. The ability to weigh and measure conflicting studies was a primary reason for creating the Aggregator.

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



Despite the mixed studies tonight and the expiration of another bullish study the green Aggregator line is still squarely 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 extremely elevated. 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 Monday. This could change if strong bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,355.53. This is 1.1% above Friday'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 strong move higher on Monday.

I already have a sizable long position. With evidence weakening a bit from Thursday, I won't be looking to add any more just yet. I do expect we should see more upside in the next few days. If Monday is another weak day up I will likely reduce my exposure and take a small amount off the table.

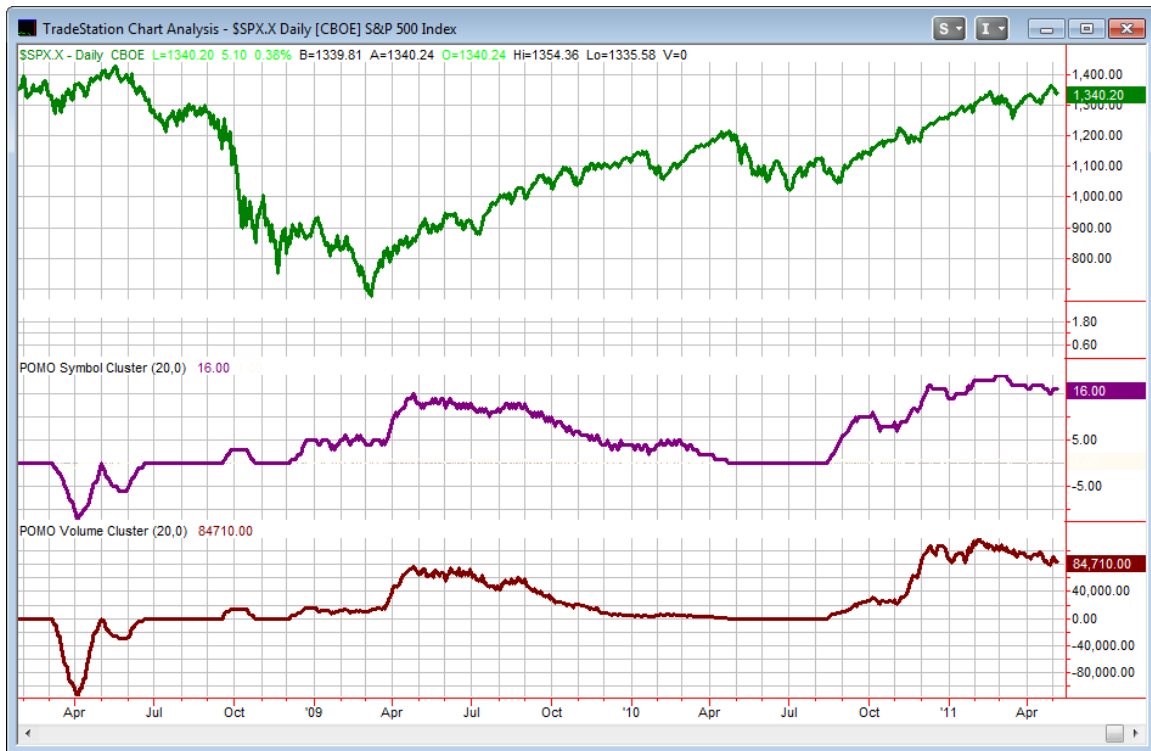
***Intermediate-term Outlook (2 weeks – 2 months)– updated 5/9 – bullish***

This wasn't a great week for the market. Monday morning marked the high and despite being up on Friday it was still at the low end of the week's range. Overall I am still seeing more positives than negatives and expect the move up isn't over. Still, this upcoming week could provide us with some very valuable insights – especially with regards to liquidity and POMO expectations.

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>



Despite 5 days of buying, the POMO indicators didn't make much headway this past week. The days indicator ticked up from 15 to 16 and the POMO Volume indicator is still near the low end of its recent range. The schedule calls for POMO buying for the next 3 trading days, and then a new schedule to be released on Wednesday.

June is when the QE2 buying is scheduled to end. It hasn't been announced whether that means June 1 or June 30 or somewhere in between. The schedule release on Wednesday could provide some indication of the Fed's intentions. I wouldn't be surprised to see the market get nervous as signs of the end approach. For now POMO activity seems to still be providing a positive influence. But that is not going to last too much longer.

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)

Despite the pullback this past week, intermediate-term indications still appear to favor the bulls. At this point there is very little suggesting a top. So I remain intermediate-term bullish. This means I will play long trades more aggressively and short trade 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	\$48.84	-0.02%		System 90609
SPY	5/4/2011	\$135.67	\$134.20	-1.08%		Aggregator
SPY	5/5/2011	\$134.08	\$134.20	0.09%		Aggregator
SPY	5/5/2011	\$133.61	\$134.20	0.44%		Aggregator

*I will look to sell 1 lot of SPY if SPX closes up at all on Monday. If we get two up days and don't make enough progress to flip the Differential line, then while there still may be an upside edge, it will not be as pronounced as it was when I took the positions. Therefore, I'll simply be looking to take a little risk off the table.*

*Should the SPX close at or above the Differential Pivot of 1,355.53, I will exit all 3 lots.*

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