

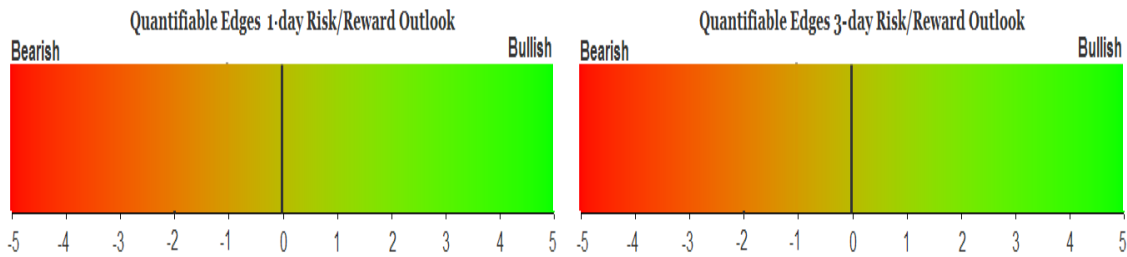
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 11, 2011

Volume 4 Issue 90

Market Overview



Tonight's Research Points

- Unfilled gaps higher after a gain the previous day that fail to reach a new 10-day high will often follow through higher short-term.
- SPX follows a 4-day drop with a 3-day rally. Under current circumstances this suggest a bullish edge.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is long.

Short-term Outlook

The Bottom Line

The bounce arrived. And while expectations remain positive the SPX has quickly become overbought. My outlook is therefore neutral.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
May 11, 2011	SPY unfilled gap up. Up yest. Close < 10 hi	1-3 days	Bullish	1.40%
May 11, 2011	SPX dn 4 then Up 3. Close < 7 days ago.	1-10 days	Bullish	3.10%
May 10, 2011	SPY up 2x but below 3 days ago	1-2 days	Bullish	1.00%
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 2, 2011	SPX > Upper BB 4 days	1-8 days	Bullish	1.90%
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	
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				
May 5, 2011	SPY 1st 5-day low in 10 days	1-4 days	Bullish	1.60%

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

The Evidence

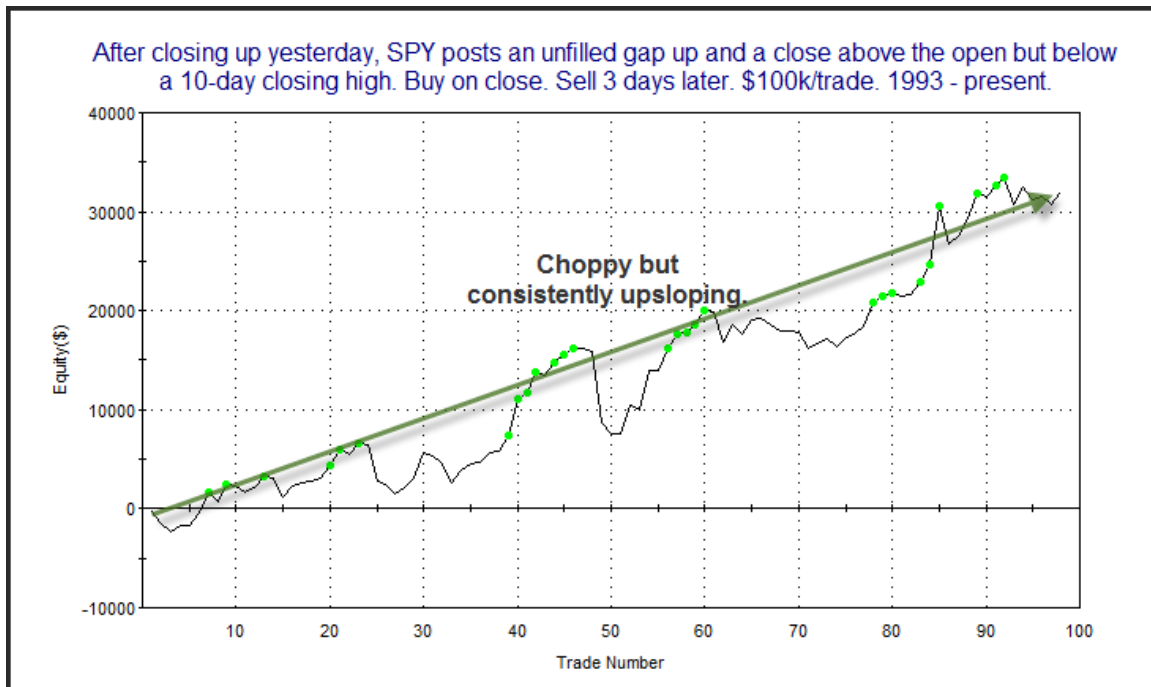
The move up we've been looking for finally kicked into gear on Tuesday. The major indices gapped higher, dipped only a little after the open, and then finished in the upper end of the day's range. The SPX finished up 0.8%, the Nasdaq gained 1.0% and the Russell 2000 rallied 1.6%. Breadth was strong as the NYSE Up Issues % came in at 80% and the Up Volume % was 79%. Total NYSE volume rose a little from Monday's level.

Tuesday's action brought about some interesting studies. This first one was last seen in the 4/21/11 Letter. It looked at unfilled gaps that occurred after an up day and closed above the open but below a 10-day high. I have updated the results below.

After closing up yesterday, SPY posts an unfilled gap up and a close above the open but below a 10-day closing high. 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	53,203.31	88	62	26	70.45	2,271.75	-3,370.96	0.67	1.61	604.58
9	58,890.44	90	62	28	68.89	2,150.98	-2,659.66	0.81	1.79	654.34
8	52,164.26	93	62	30	66.67	2,053.79	-2,505.70	0.82	1.69	560.91
7	25,603.17	94	56	37	59.57	2,046.73	-2,405.78	0.85	1.29	272.37
6	33,095.95	94	56	38	59.57	2,028.22	-2,118.01	0.96	1.41	352.08
5	18,099.20	95	54	41	56.84	1,703.55	-1,802.26	0.95	1.24	190.52
4	24,230.03	96	60	36	62.50	1,379.21	-1,625.63	0.85	1.41	252.40
3	32,076.92	98	60	38	61.22	1,228.54	-1,095.67	1.12	1.77	327.32
2	17,447.59	99	58	40	58.59	1,044.19	-1,077.88	0.97	1.40	176.24
1	7,190.70	105	60	43	57.14	603.66	-675.08	0.89	1.25	68.48

85% of instances posted a close above the entry price at some point in the next week.

Gains here are a little modest, but the consistency is quite good. The stat noted in the bottom of the table is especially impressive considering the setup requires the SPY to have already risen the last 2 days. I did peek at performance above and below the 200ma and found little difference between the 2. Therefore I decided it wasn't worthwhile to distinguish for this study. Below is an equity curve using a 3-day exit strategy.



The equity curve confirms the bullish edge suggested by the stats table.

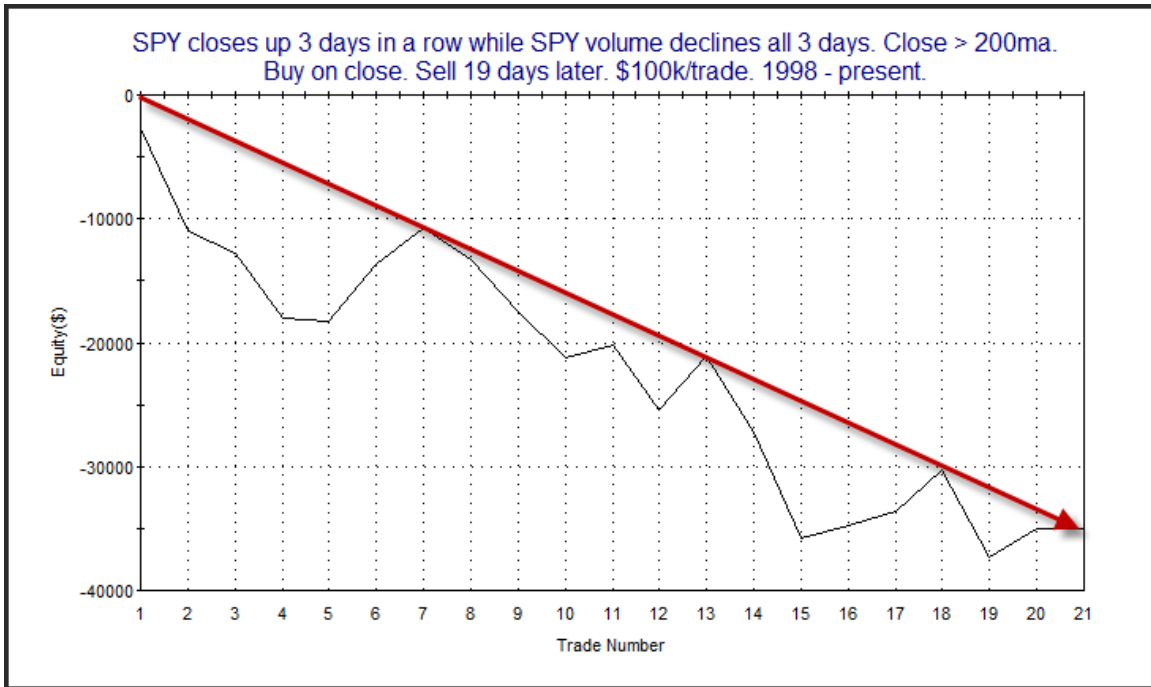
Another study that triggered tonight was last shown just about a week ago in the 5/2/11 Letter. I have copied an excerpt from that letter below. Stats have NOT been updated.

That study looked at the rise in SPY on declining volume each of the last 3 days...

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.

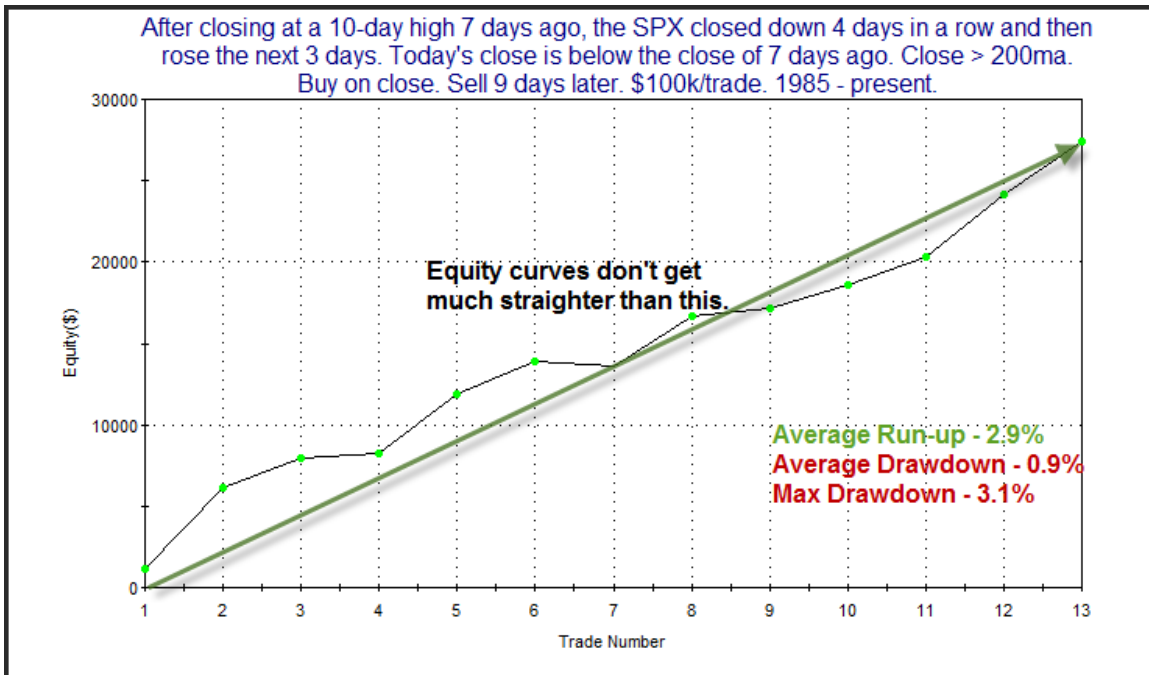
In addition to the studies above from the Quantifinder, I also decided to explore the pattern the SPX has carved out over the last several days. What I noted was that after making a new high it then pulled back for 4 days in a row. That 4 day drop has now been followed by a 3-day rally. At this point the market has not managed to overcome the recent highs. So I plugged those observations into a study and found some very compelling results.

After closing at a 10-day high 7 days ago, the SPX closed down 4 days in a row and then rose the next 3 days. Today's close is below the close of 7 days ago. Close > 200ma.
Buy on close. Sell X days later. \$100k/trade. 1985 - 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	30,294.55	13	12	1	92.31	2,615.70	-1,093.81	2.39	28.70	2,330.35
9	27,408.35	13	12	1	92.31	2,311.10	-324.85	7.11	85.37	2,108.33
8	25,708.01	13	12	1	92.31	2,158.35	-192.24	11.23	134.73	1,977.54
7	24,861.74	13	11	2	84.62	2,311.56	-282.73	8.18	44.97	1,912.44
6	22,250.35	13	11	2	84.62	2,142.31	-657.52	3.26	17.92	1,711.57
5	15,336.22	13	11	2	84.62	1,594.86	-1,103.65	1.45	7.95	1,179.71
4	12,770.73	13	10	3	76.92	1,700.11	-1,410.11	1.21	4.02	982.36
3	8,963.65	13	9	4	69.23	1,505.46	-1,146.38	1.31	2.95	689.51
2	4,022.44	13	8	5	61.54	1,077.18	-919.00	1.17	1.88	309.42
1	-1,166.31	13	6	7	46.15	667.39	-738.67	0.90	0.77	-89.72

All 13 instances posted at least 1 close above the entry price at some point in the next 6 days.

While the number of instances was smaller than I would prefer the statistics appear to heavily favor the bull side. The 8-10 day numbers appear especially strong. So using a 9-day exit strategy I created the equity curve below.



This curve is especially appealing. The run-up and drawdown numbers shown in the lower right hand corner are also notable. They show how heavily reward has outsized risk. For those that would like to dig deeper, I have also listed all 13 instances below.

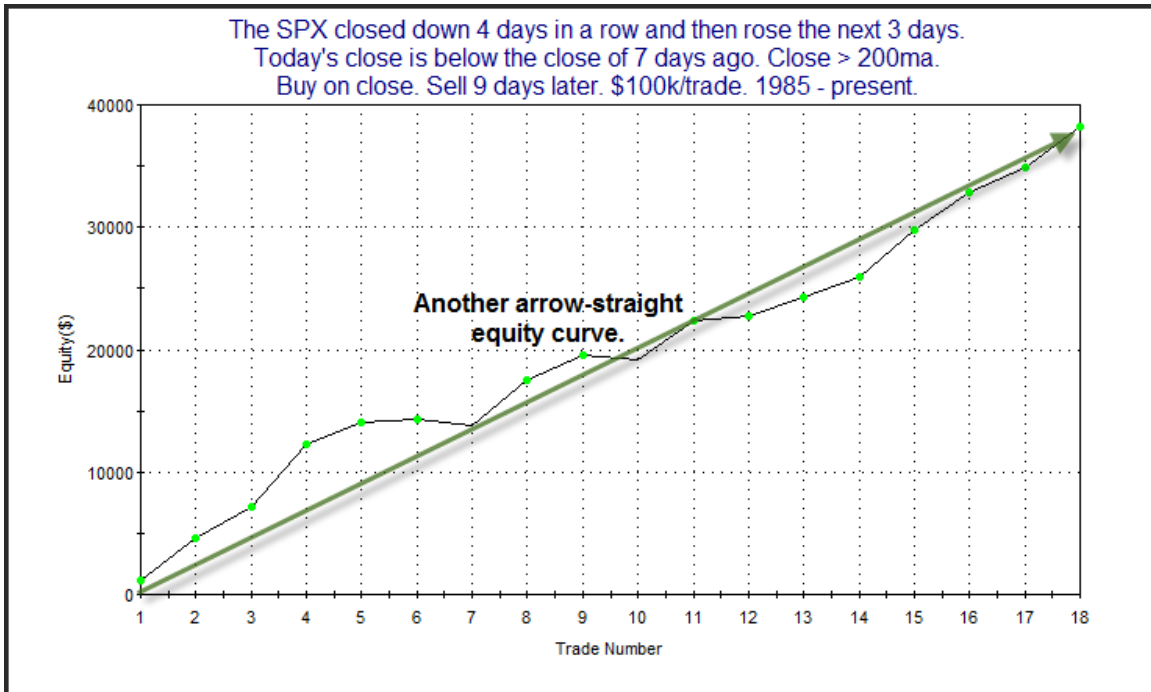
After closing at a 10-day high 7 days ago, the SPX closed down 4 days in a row and then rose the next 3 days. Today's close is below the close of 7 days ago. Close > 200ma. Buy on close. Sell 9 days later. \$100k/trade. 1985 - present.				
Date/Time	Signal	Price	% Profit	Run-up DrawDown
04/11/85	Buy	\$180.19	1.14%	\$1,307.44
04/24/85	Sell	\$182.25		(\$77.56)
07/28/87	Buy	\$312.33	5.02%	\$5,014.40
08/10/87	Sell	\$328.00		(\$195.20)
12/22/89	Buy	\$347.41	1.84%	\$3,782.66
01/08/90	Sell	\$353.79		(\$252.56)
11/26/93	Buy	\$463.06	0.24%	\$823.45
12/09/93	Sell	\$464.18		(\$561.15)
05/10/96	Buy	\$652.09	3.67%	\$4,438.53
05/23/96	Sell	\$676.00		\$0.00
01/14/98	Buy	\$957.92	2.04%	\$2,153.84
01/28/98	Sell	\$977.46		(\$795.60)
05/01/98	Buy	\$1,121.02	(0.33%)	\$845.50
05/14/98	Sell	\$1,117.37		(\$2,357.61)
11/17/98	Buy	\$1,139.32	3.16%	\$4,666.68
12/01/98	Sell	\$1,175.28		(\$544.62)
01/20/99	Buy	\$1,256.62	0.43%	\$2,134.58
02/02/99	Sell	\$1,261.99		(\$3,050.98)
01/27/05	Buy	\$1,174.55	1.48%	\$2,597.60
02/09/05	Sell	\$1,191.99		(\$701.25)
12/23/05	Buy	\$1,268.66	1.69%	\$1,725.36
01/09/06	Sell	\$1,290.15		(\$1,787.76)
09/08/09	Buy	\$1,025.39	3.83%	\$4,726.81
09/21/09	Sell	\$1,064.66		(\$137.74)
04/15/11	Buy	\$1,319.68	3.33%	\$3,366.00
04/29/11	Sell	\$1,363.61		(\$1,873.50)

Since the number of instances was a bit low, I decided I would also loosen the criteria a bit. Therefore, I eliminated the need for SPX to post a 10-day high prior to the 4-day pullback. The new results are below.

The SPX closed down 4 days in a row and then rose the next 3 days.
 Today's close is below the close of 7 days ago. Close > 200ma.
 Buy on close. Sell X days later. \$100k/trade. 1985 - present.

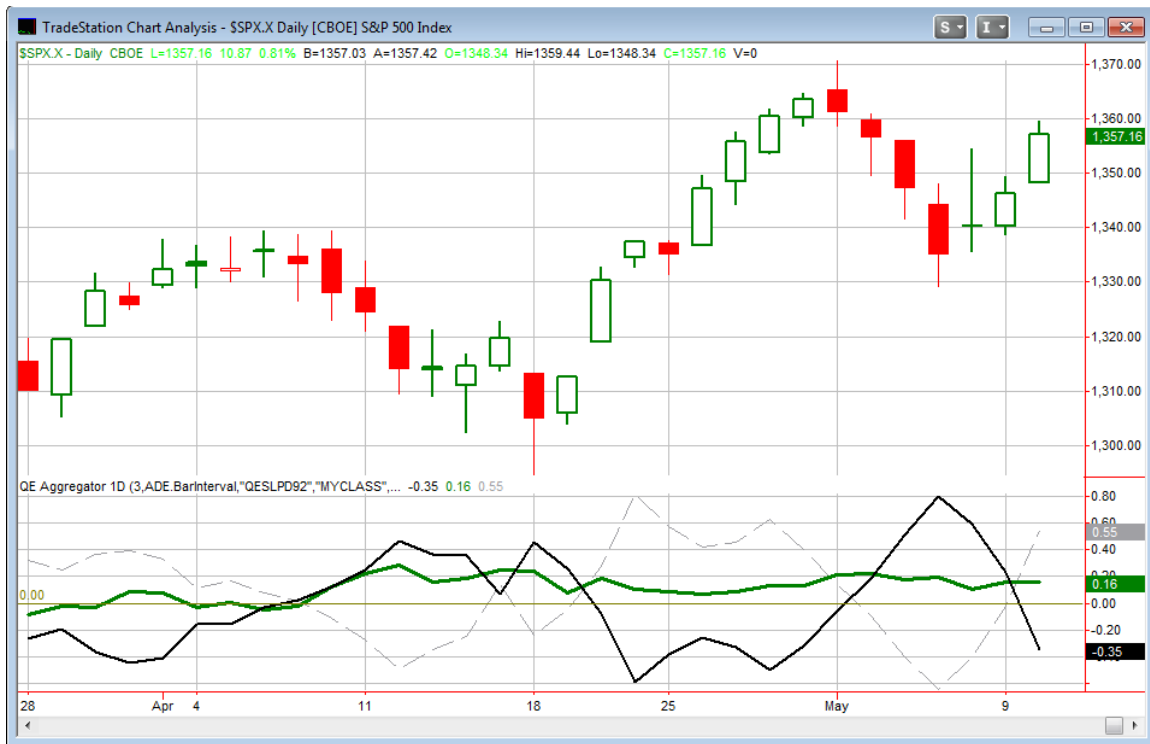
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	40,940.97	18	16	2	88.89	2,666.12	-858.51	3.11	24.84	2,274.50
9	38,229.47	18	16	2	88.89	2,439.48	-401.07	6.08	48.66	2,123.86
8	33,554.94	18	16	2	88.89	2,245.62	-1,187.48	1.89	15.13	1,864.16
7	30,699.14	18	15	3	83.33	2,235.70	-945.45	2.36	11.82	1,705.51
6	25,801.04	18	14	4	77.78	2,238.08	-1,383.00	1.62	5.66	1,433.39
5	17,681.53	18	13	5	72.22	1,842.49	-1,254.18	1.47	3.82	982.31
4	13,348.02	18	13	5	72.22	1,602.52	-1,496.95	1.07	2.78	741.56
3	8,493.34	18	12	6	66.67	1,381.66	-1,347.77	1.03	2.05	471.85
2	5,394.75	18	11	7	61.11	1,081.10	-928.19	1.16	1.83	299.71
1	-120.21	18	8	10	44.44	739.18	-603.36	1.23	0.98	-6.68

This didn't add as many instances as I thought it would, but the ones it did add still appeared to suggest an upside edge. Below is the equity curve using a 9-day exit strategy again.



Again, the equity curve looks very compelling.

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



With tonight's studies included the green Aggregator line remains 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 rally over the last 3 days has caused the black Differential Line to dive back 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 versus recent expectations. This is considered a neutral configuration. Neutral configurations can be seen on the chart whenever both lines close on opposite sides of 0. Due to this the Aggregator System changed from long to flat at the close.

The green Aggregator line is again set to close above 0 on Wednesday. This could change if strong bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,346.54. This is about 0.8% below Tuesday's close. This means the SPX would need to drop at least this much for the Differential Line to close back above 0.

Expectations remain bullish. And if you're trading a trend-following strategy at the moment then there doesn't appear to be a good reason to abandon long positions. But the way I designed the Aggregator system and the way I conduct my own short-term trading is to step aside when the SPX becomes overbought as determined by the Differential line. That is what I did today. As you'll see in the Trade Ideas section below all open trades

were exited at the close as instructed in last night's letter. At this point I am flat and awaiting the next favorable trade opportunity.

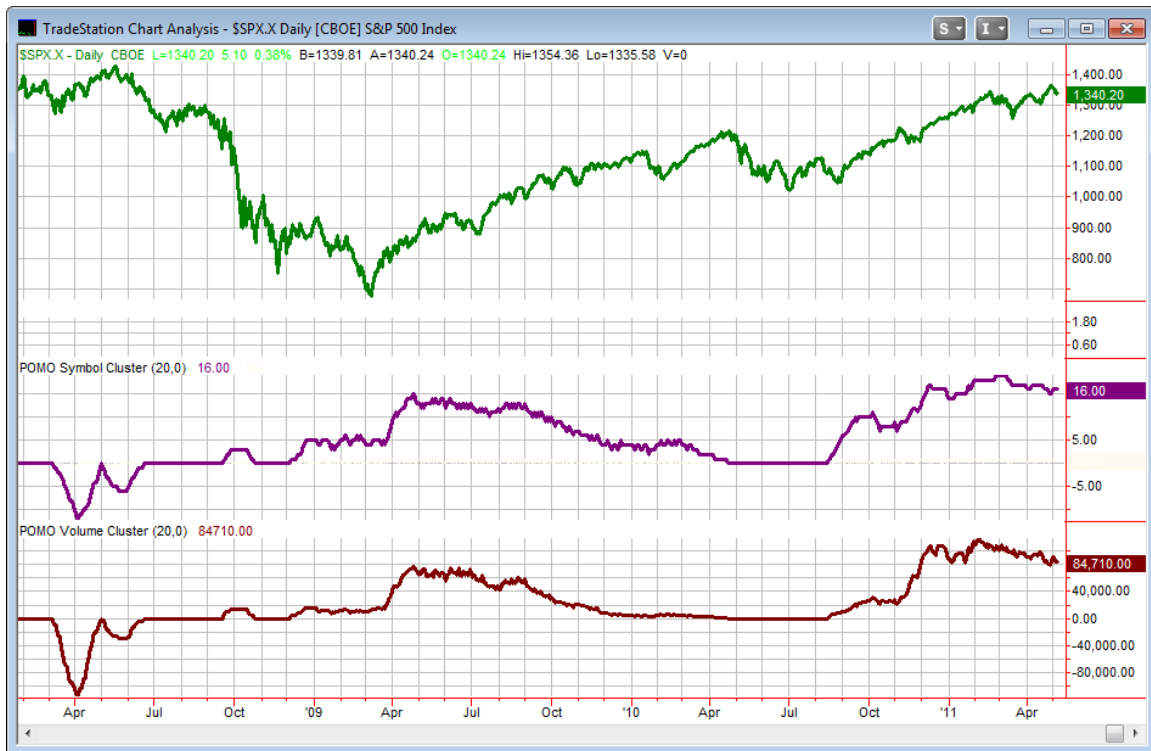
Intermediate-term Outlook (2 weeks – 2 months)– updated 5/9 – bullish

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 3rd 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

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	\$49.74	1.82%		<i>sold on close</i>
SPY	5/4/2011	\$135.67	\$135.87	0.15%		<i>sold on close</i>
SPY	5/5/2011	\$133.61	\$135.87	1.69%		<i>sold on close</i>

Per last night's letter SPY was sold at the close.

Per system 90609, EPP was sold at the close.

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