

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 13, 2011

Volume 4 Issue 92

Market Overview



Tonight's Research Points

- Thursday's SPY pattern of gap down, sell off further, and then reverse strongly would contain bearish implications in a downtrending environment, but not in an uptrend like the market is now.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is long.

Short-term Outlook

The Bottom Line

There still appears to be a moderate upside edge. I am looking for further gains and holding on to my small long position.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
May 13, 2011	SPY gap down and reverse up.	1-4 days	Bullish	1.90%
May 12, 2011	SPY unfilled gap up. Unfilled gap down.	1-3 days	Bearish	-1.95%
May 12, 2011	SPX dn 1%. Decliners 2x advancers	1-9 days	Bullish	3.05%
May 11, 2011	SPY unfilled gap up. Up yest. Close < 10hi	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%
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 6, 2011	Down 4 days. Today's is the worst.	1-5 days	Bullish	2.10%

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

The Evidence

The bears controlled the first 15 minutes of trading on Thursday but the bulls took over after that, making for a reversal bar on the charts. The major indices all saw decent gains as the SPX rose 0.5%, the Nasdaq was up 0.6% and the Russell 2000 gained 0.8%. Breadth was only modestly positive as the NYSE Up Issues % came in at 60% and the Up Volume % was 57%. Total NYSE volume declined slightly from Wednesday's level.

There were several studies in the Quantifinder tonight that looked at gaps down in the SPY that dropped well below the open and then reversed to close positive and strongly above the open. A few of these studies suggested bearish consequences, but those failed to look at the long-term trend. In the 11/30/10 Subscriber Letter I filtered the pattern using the 200ma. I've updated the results from that letter below for both uptrends and downtrends.

First I'll show the downtrend results which had strongly bearish inclinations.

SPY gaps down at least 0.25%. It then trades 0.5% below the open but does not make a 10-day low before reversing to close positive on the day and at least 0.5% above the open. 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
6	-28,862.17	22	9	13	40.91	3,235.86	-4,460.38	0.73	0.50	-1,311.92
5	-34,218.80	22	9	13	40.91	1,660.30	-3,781.66	0.44	0.30	-1,555.40
4	-54,817.26	23	7	16	30.43	1,193.37	-3,948.18	0.30	0.13	-2,383.36
3	-40,046.02	24	9	15	37.50	1,589.14	-3,623.22	0.44	0.26	-1,668.58
2	-47,198.57	24	6	17	25.00	2,141.51	-3,532.21	0.61	0.21	-1,966.61
1	-18,605.08	26	11	15	42.31	1,359.38	-2,237.21	0.61	0.45	-715.58

Especially over the first 2-4 days this study suggests a downside edge. But I showed in the 11/30/10 letter that that edge was no longer apparent above the 200ma. Those stats are updated below.

SPY gaps down at least 0.25%. It then trades 0.5% below the open but does not make a 10-day low before reversing to close positive on the day and at least 0.5% above the open. 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
10	9,768.46	12	8	4	66.67	2,697.70	-2,953.28	0.91	1.83	814.04
9	17,195.76	12	9	3	75.00	2,629.21	-2,155.71	1.22	3.66	1,432.98
8	18,784.66	12	9	3	75.00	2,580.32	-1,479.40	1.74	5.23	1,565.39
7	16,825.18	12	9	3	75.00	2,025.24	-467.31	4.33	13.00	1,402.10
6	13,004.80	12	10	2	83.33	1,740.70	-2,201.12	0.79	3.95	1,083.73
5	10,352.17	12	8	4	66.67	1,582.61	-577.17	2.74	5.48	862.68
4	11,041.36	12	9	3	75.00	1,524.83	-894.04	1.71	5.12	920.11
3	2,943.16	12	7	5	58.33	1,393.37	-1,362.08	1.02	1.43	245.26
2	6,727.65	12	7	5	58.33	1,213.22	-352.98	3.44	4.81	560.64
1	-585.56	12	7	5	58.33	577.49	-925.60	0.62	0.87	-48.80

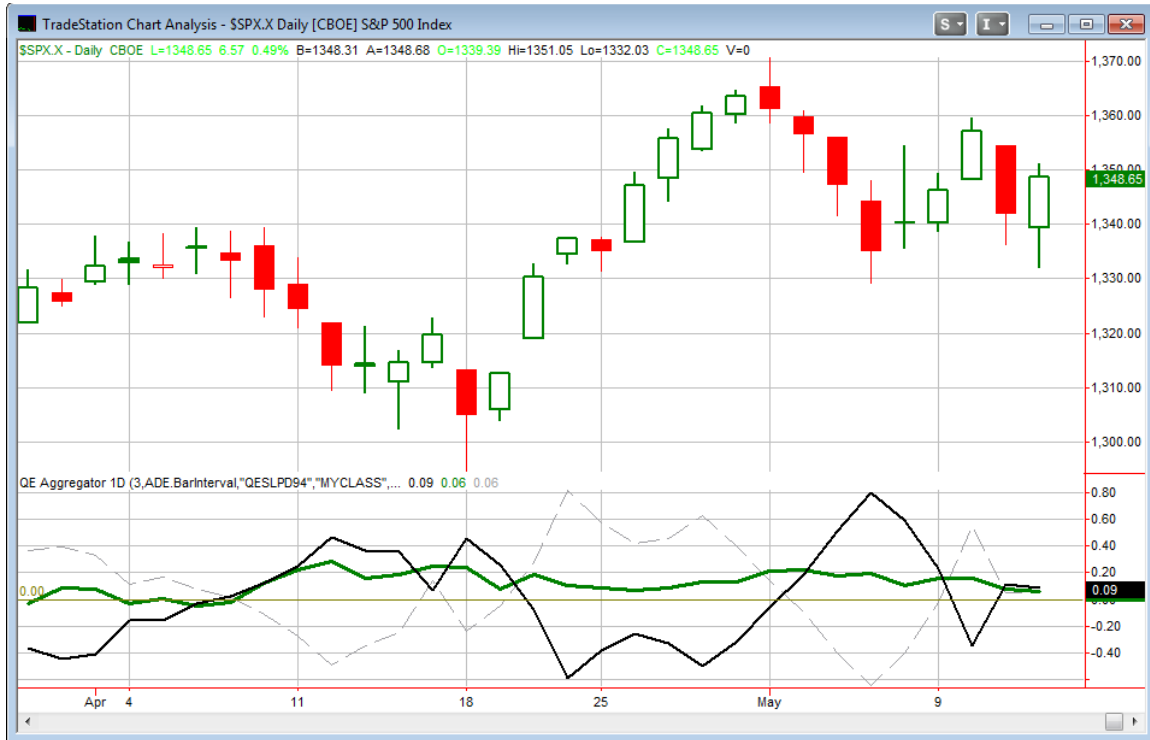
The low number of instances is a bit concerning but the stats appear quite strong. Before deciding whether to include the study on the Active List I decided to take a closer look at the instances. I have listed all of them below using a 6-day exit strategy.

SPY gaps down at least 0.25%. It then trades 0.5% below the open but does not make a 10-day low before reversing to close positive on the day and at least 0.5% above the open. Close > 200ma. Buy on close. Sell 6 days later. \$100k/trade. 1994 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
11/19/97	Buy	\$94.66	1.02%	\$2,270.40
11/28/97	Sell	\$95.63		(\$31.68)
02/12/98	Buy	\$102.53	1.49%	\$1,677.00
02/23/98	Sell	\$104.06		(\$633.75)
08/06/98	Buy	\$108.94	(2.58%)	\$1,513.05
08/14/98	Sell	\$106.13		(\$3,154.48)
12/11/98	Buy	\$117.13	2.59%	\$3,591.13
12/21/98	Sell	\$120.16		(\$2,883.14)
11/24/99	Buy	\$141.97	1.32%	\$2,372.48
12/03/99	Sell	\$143.84		(\$2,090.88)
03/21/00	Buy	\$149.19	1.36%	\$4,395.20
03/29/00	Sell	\$151.22		(\$335.00)
08/26/03	Buy	\$100.11	3.30%	\$3,443.10
09/04/03	Sell	\$103.41		(\$449.10)
09/12/03	Buy	\$102.45	0.10%	\$2,196.00
09/22/03	Sell	\$102.55		(\$488.00)
07/24/09	Buy	\$98.06	2.43%	\$2,516.93
08/03/09	Sell	\$100.44		(\$1,100.52)
04/22/10	Buy	\$121.02	(1.83%)	\$908.60
04/30/10	Sell	\$118.81		(\$2,288.02)
10/12/10	Buy	\$117.01	0.73%	\$1,417.64
10/20/10	Sell	\$117.87		(\$845.46)
11/29/10	Buy	\$119.16	3.08%	\$4,069.15
12/07/10	Sell	\$122.83		(\$1,132.65)

Results here appear strong and steady. There are no huge outliers skewing the stats. This gives me some degree of comfort in including the study on the Active List.

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



Between the study that expired and the new study that arrived the green Aggregator Line didn't move much tonight. It is still hovering a little 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 also barely budged. It too remains slightly positive. Readings above 0 mean the SPX has underperformed expectations over the last few days. So net expectations are for upside and the SPX is relatively oversold versus recent expectations. Historically this combination has provided an upside 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 Friday. This could change if strong bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,362.71. This is a little over a 1% rise from Thursday's close. So for the black Differential Line to move back above 0 the SPX would need to rally at least this much.

The market has been chopping around for a couple of weeks now. Thursday's close put the SPX almost exactly in the middle of its recent (10-day) range. It could break or wiggle either way from here, but we have ample evidence suggesting an upside edge. Still, mid-range is not a place I prefer to take on new positions. So for now I'll just manage the current small position I already have. There were a good number of stocks and ETFs that triggered setups for the numbered systems tonight. Traders who are looking to trade a bit more aggressively could look to the triggers spreadsheet on the systems page for some ideas.

You may have noticed that the 1-day Risk/Reward Outlook at the top of the letter is at 0. While the 3-day expectations are squarely positive, tomorrow's net expectations are actually slightly negative. Reasons for this are 1) last night's bearish study showed its greatest bearish influence on day 2, and 2) tonight's bullish study actually has a negative expectation for day 1. So while I expect a rise over the next few days, Friday's outlook is less clear.

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

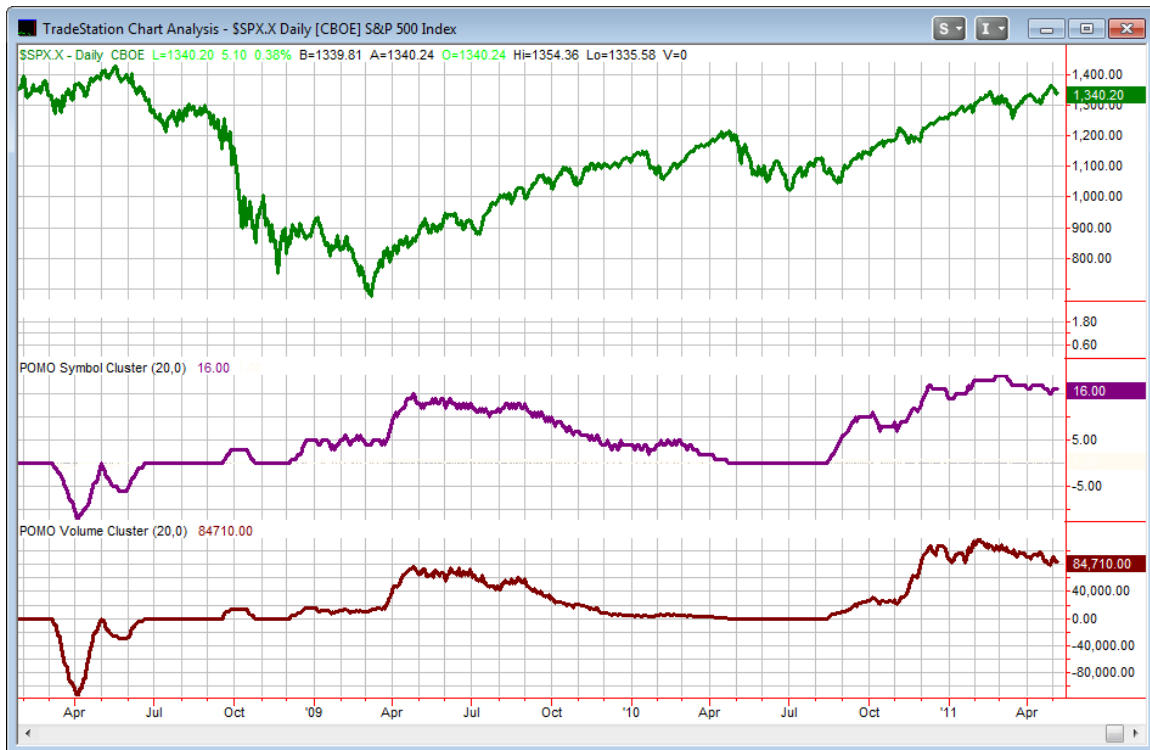
This wasn't a great week for the market. Monday morning marked the high and despite being up on Friday it was still at the low end of the week's range. Overall I am still seeing more positives than negatives and expect the move up isn't over. Still, this upcoming week could provide us with some very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

None tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	5/12/2011	\$134.09	\$135.08	0.74%		bought on open

I will exit the SPY position on close if SPX closes \geq 1,362.71.

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