

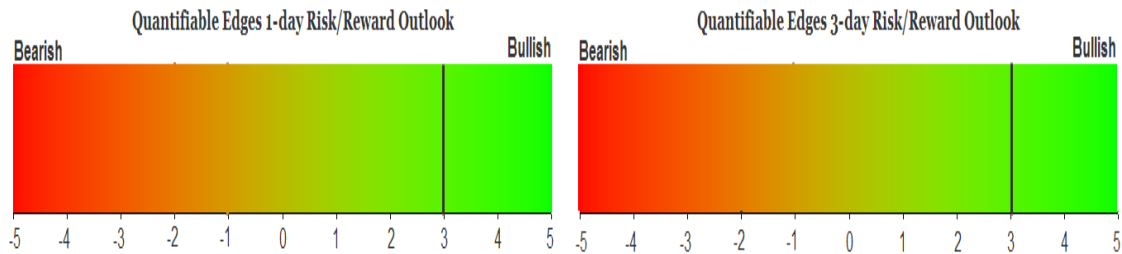
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 23, 2011

Volume 4 Issue 98

Market Overview



Tonight's Research Points

- When op-ex Friday has closed down, the next day has performed very well over the last 5 years.
- When SPY leaves an unfilled gap down on Friday, it has suggested an upside edge for Monday.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is long.

Short-term Outlook

The Bottom Line

Friday's selloff quickly moved the market back to "oversold vs. expectations". With short-term studies all bullish, there again appears to be an upside edge. I am looking to take advantage of it with some long-side positions.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
May 23, 2011	Down Fri op-ex / unfilled gap	1 day	Bullish	
May 18, 2011	SPY gap down and partial reverse up.	1-5 days	Bullish	1.90%
May 12, 2011	SPX dn 1%. Decliners 2x advancers	1-9 days	Bullish	3.05%
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	

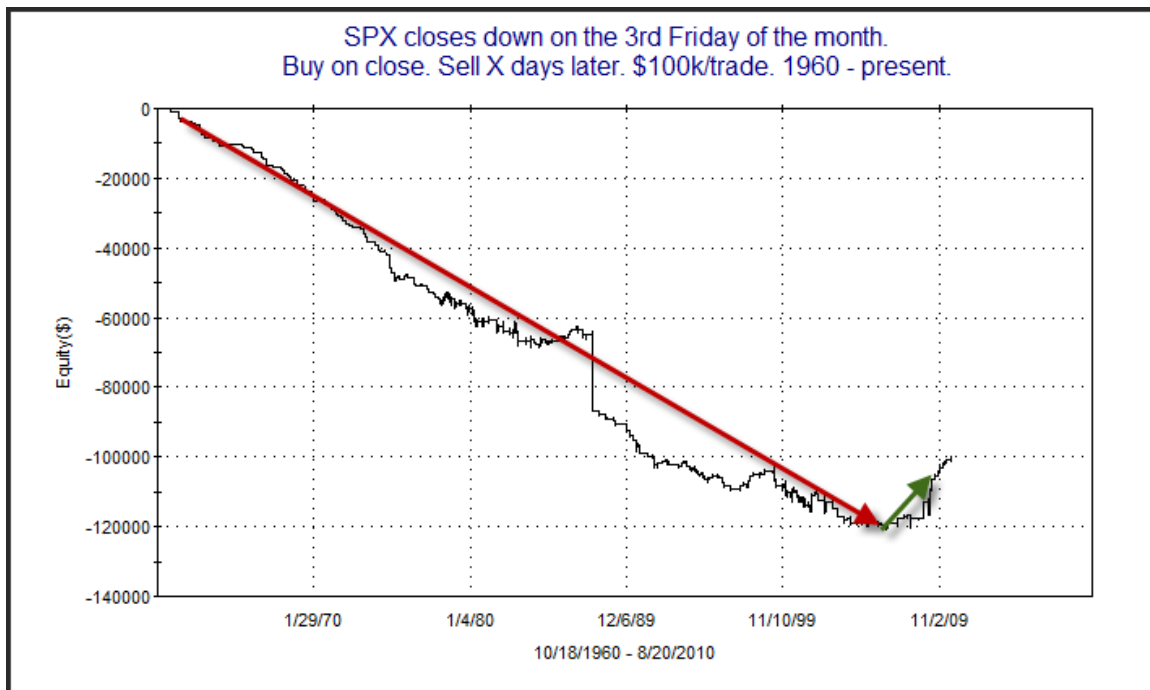
If the avg max move is achieved the study will appear in **bold italic blue** and no longer be active.

The Evidence

Friday was tough day for the market. It gapped down at the open, never filled the opening gap or got much above the open, and finished near its lows for the day. When it was over the SPX had lost 0.8%, and the NASDAQ and Russell 2000 were both down 0.7%. Breadth was weak as the NYSE Up Issues % came in at 33% and the Up Volume % was 27%. Total NYSE volume came in at the highest level in a couple of weeks.

It had been a while since op-ex Friday finished down. The last occurrence was way back in August. At that time I showed a study that revealed Mondays following down op-ex Fridays have performed well over the last few years. The excerpt below is from the 8/23/10 subscriber letter.

I checked the wayback machine to see how the market performed after a negative performance on the 3rd Friday of the month. The equity curve below shows the results since 1960.



I don't recall exactly when options began trading. In any case, I've demonstrated before that through 1987 Mondays had an overall negative expectation. This changed after the Crash of '87 when Mondays began to follow the general trend of the market. According

to the above graphic, down Mondays following down “3rd Fridays” persisted until 2006. But since mid-2006 the edge has apparently flipped as gains have become much more frequent than losses. Below are the performance statistics over this more recent period.

(Study is updated.)

SPX closes down on the 3rd Friday of the month. Buy on close. Sell X days later. \$100k/trade. 7/1/2006 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$20,018.41	Profit Factor	5.04
Gross Profit	\$24,969.73	Gross Loss	(\$4,951.32)
Total Number of Trades	19	Percent Profitable	84.21%
Winning Trades	16	Losing Trades	3
Even Trades	0		
Avg. Trade Net Profit	\$1,053.60	Ratio Avg. Win:Avg. Loss	0.95
Avg. Winning Trade	\$1,560.61	Avg. Losing Trade	(\$1,650.44)
Largest Winning Trade	\$7,069.40	Largest Losing Trade	(\$3,446.88)

While this pattern used to suggest a downside edge, it now appears to suggest an upside edge.

For those that would like a closer examination, below I have list all 19 instances since mid-2006.

SPX closes down on the 3rd Friday of the month.
Buy on close. Sell X days later. \$100k/trade. 7/1/2006 - present.

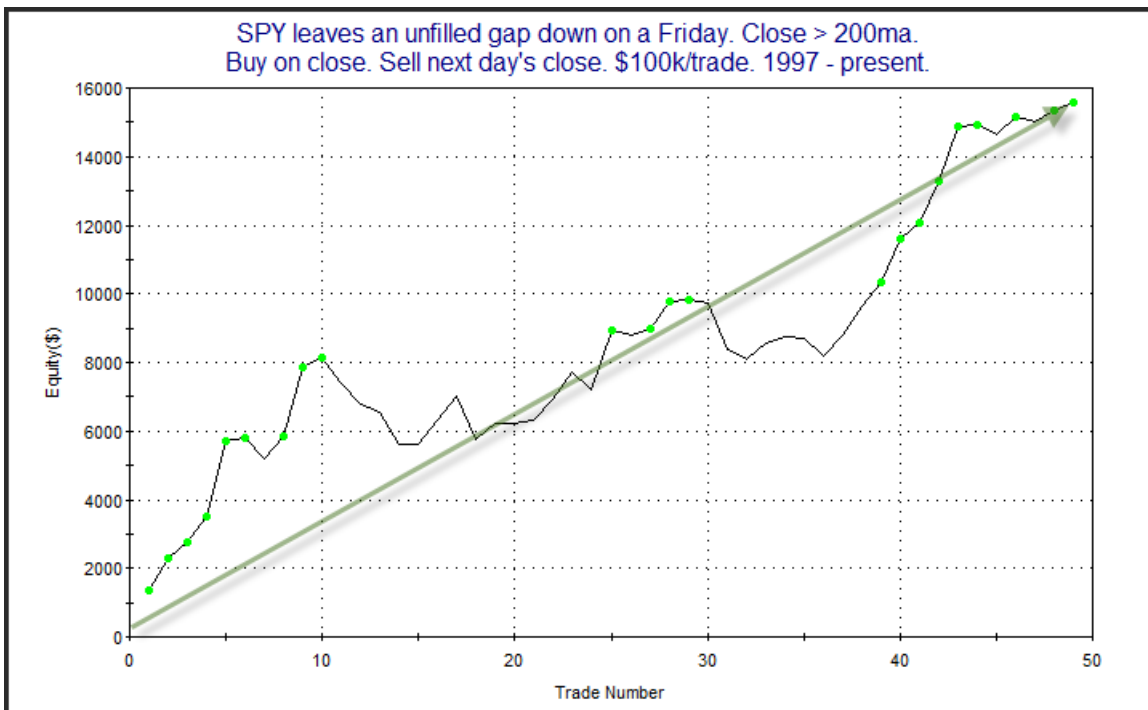
Date/Time	Signal	Price	% Profit	Run-up DrawDown
07/21/06	Buy	\$1,240.29	1.66%	\$1,776.80
07/24/06	Sell	\$1,260.91		\$0.00
02/16/07	Buy	\$1,455.54	0.28%	\$339.32
02/20/07	Sell	\$1,459.68		(\$431.12)
03/16/07	Buy	\$1,386.95	1.09%	\$1,170.00
03/19/07	Sell	\$1,402.06		\$0.00
07/20/07	Buy	\$1,534.10	0.49%	\$853.45
07/23/07	Sell	\$1,541.57		\$0.00
10/19/07	Buy	\$1,500.61	0.38%	\$491.70
10/22/07	Sell	\$1,506.33		(\$673.86)
01/18/08	Buy	\$1,325.20	(1.11%)	\$0.00
01/22/08	Sell	\$1,310.51		(\$3,818.25)
06/20/08	Buy	\$1,317.86	0.01%	\$444.00
06/23/08	Sell	\$1,318.02		(\$191.25)
10/17/08	Buy	\$940.55	4.77%	\$4,754.10
10/20/08	Sell	\$985.40		\$0.00
02/20/09	Buy	\$770.05	(3.47%)	\$1,006.20
02/23/09	Sell	\$743.33		(\$3,570.72)
03/20/09	Buy	\$768.54	7.08%	\$7,127.90
03/23/09	Sell	\$822.92		\$0.00
05/15/09	Buy	\$882.88	3.04%	\$3,064.56
05/18/09	Sell	\$909.71		\$0.00
07/17/09	Buy	\$940.38	1.14%	\$1,191.44
07/20/09	Sell	\$951.13		\$0.00
10/16/09	Buy	\$1,087.68	0.94%	\$1,136.59
10/19/09	Sell	\$1,097.91		(\$109.20)
11/20/09	Buy	\$1,091.38	1.36%	\$1,911.00
11/23/09	Sell	\$1,106.24		\$0.00
01/15/10	Buy	\$1,136.03	1.25%	\$1,268.96
01/19/10	Sell	\$1,150.23		(\$7.04)
03/19/10	Buy	\$1,159.90	0.51%	\$681.12
03/22/10	Sell	\$1,165.81		(\$603.72)
04/16/10	Buy	\$1,192.13	0.45%	\$476.42
04/19/10	Sell	\$1,197.52		(\$701.35)
07/16/10	Buy	\$1,064.88	0.60%	\$913.26
07/19/10	Sell	\$1,071.25		(\$350.61)
08/20/10	Buy	\$1,071.69	(0.40%)	\$919.77
08/23/10	Sell	\$1,067.36		(\$428.73)

Being that Friday also saw an unfilled gap down in the SPY, I also decided to see if that suggested any kind of an edge. Below is one way in which I looked at it.

SPY leaves an unfilled gap down on a Friday. Close > 200ma.
Buy on close. Sell next day's close. \$100k/trade. 1997 - present.

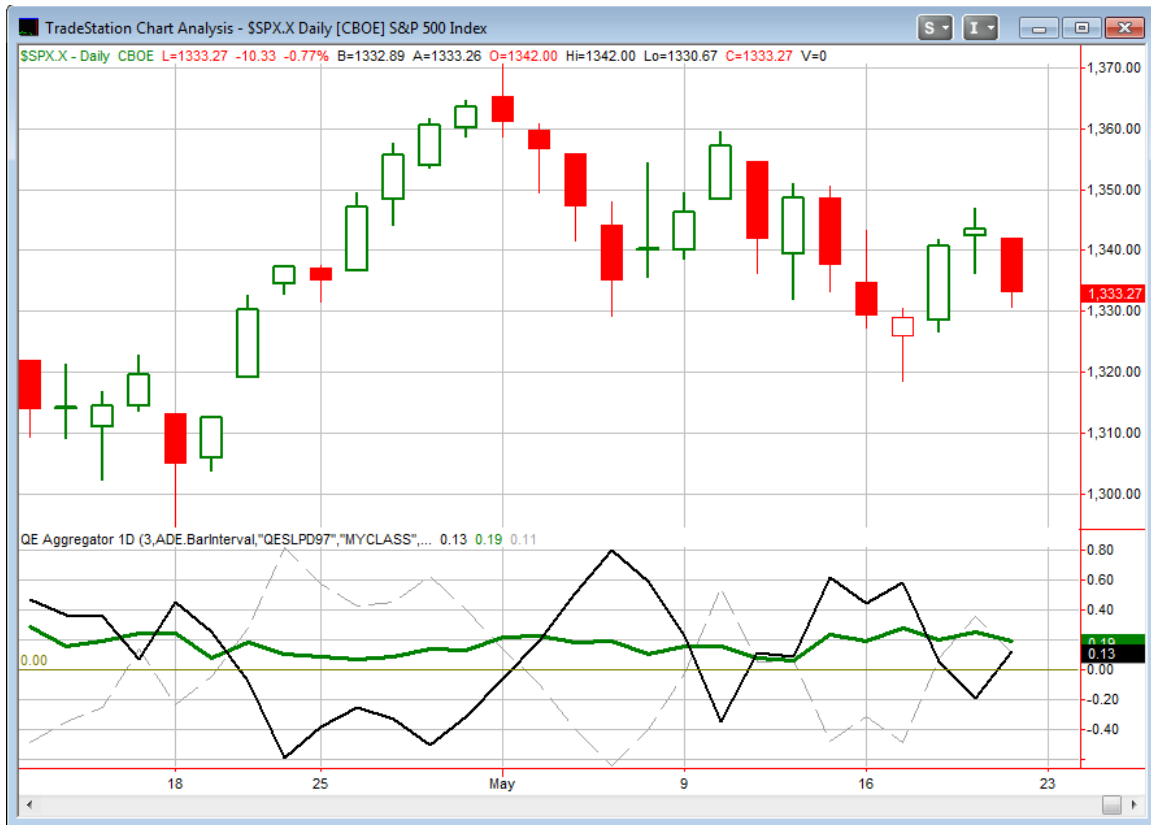
TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	\$15,579.82	Profit Factor	3.00
Gross Profit	\$23,364.99	Gross Loss	(\$7,785.17)
Total Number of Trades	49	Percent Profitable	67.35%
Winning Trades	33	Losing Trades	15
Even Trades	1		
Avg. Trade Net Profit	\$317.96	Ratio Avg. Win:Avg. Loss	1.36
Avg. Winning Trade	\$708.03	Avg. Losing Trade	(\$519.01)
Largest Winning Trade	\$2,196.55	Largest Losing Trade	(\$1,374.16)

Results above the 200ma have been quite good for the last 14 years or so. Below the 200ma there was no apparent edge.



Even with Friday's selloff the market remains locked in a trading range. So while there are some studies pointing to a possible rise on Monday, evidence is still fairly scarce in general.

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



The green Aggregator Line remained strongly above 0 again tonight. This is largely due to complete lack of bearish studies on the short-term Active List. The positive value means the net expectation from the Active Studies List is for upside over the next few days. Meanwhile, the sharp drop in the SPX caused the black Differential Line to jump back into positive territory. 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 configuration has suggested an upside edge. It can be seen on the chart whenever both lines close above 0. Due to this the Aggregator System changed from flat to long at the close.

Without any short-term bearish studies on the Active List 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 1,349.52. This is about 1.2% above Friday's close. So it would take a sharp rally on Monday to flip the Differential line back to negative. It's more likely that we may see the market move higher for multiple days from here before the long signal is changed.

There appears to be a moderate upside edge and I intend to take advantage of it. I will look to begin scaling in to a long position on Monday.

Intermediate-term Outlook (2 weeks – 2 months)– updated 5/23 – moderately bullish

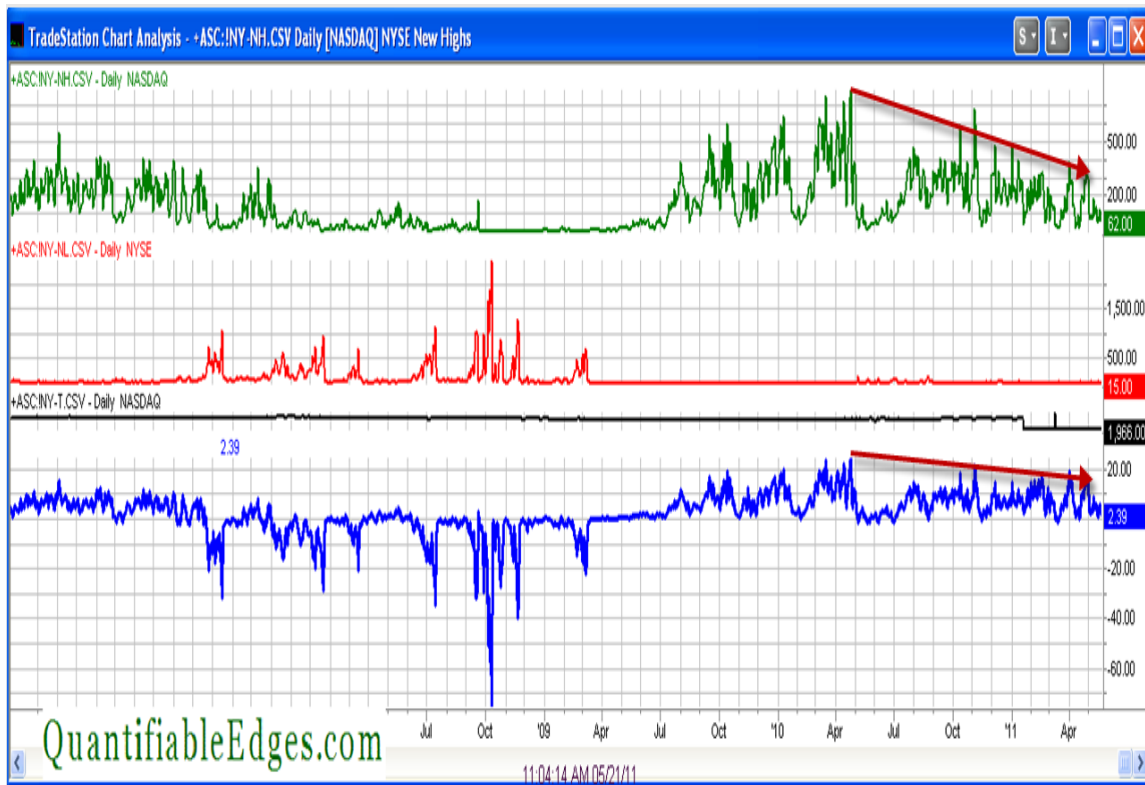
Friday's move down meant the recent upswing just posted a lower high. This is the second lower swing high we've had since the 5/2 peak. The first was on 5/10 and now the second can be seen on 5/19. We've also seen a lower low made during that time. The 5/17 low was below the 5/5 low. So it appears we are now seeing the market make a series of lower highs and lower lows. There is a word for a series of lower highs and lower lows - downtrend. A move below the 5/17 low would make it obvious. That would also take it below its 50-day moving average.

So are we seeing a mini move down, or is this the start of something big?

Breadth can often provide clues about impending tops. Major tops almost always see a divergence of breath before prices begin to turn down. I published a study along with a number of detailed charts in the 10/12/09 subscriber letter. Readers who are interested in reviewing that may use the link below to access it.

[2009-10-12 QE Subscriber Letter.pdf](#)

In that study I looked at two measures of breath. One was the advance/decline line and the other was the percentage of stocks hitting new highs. There is no divergence in the advance decline line at this point. It made a new high just recently on 5/10. There is a divergence in the number of new highs, and it's a divergence that has been in place for a little over a year now. The chart below is the long-term new highs and new lows chart from the charts page. You can clearly see how the number of new highs in the top pane, and the net percentage in the bottom pane, have both been trending lower since around April 2010.

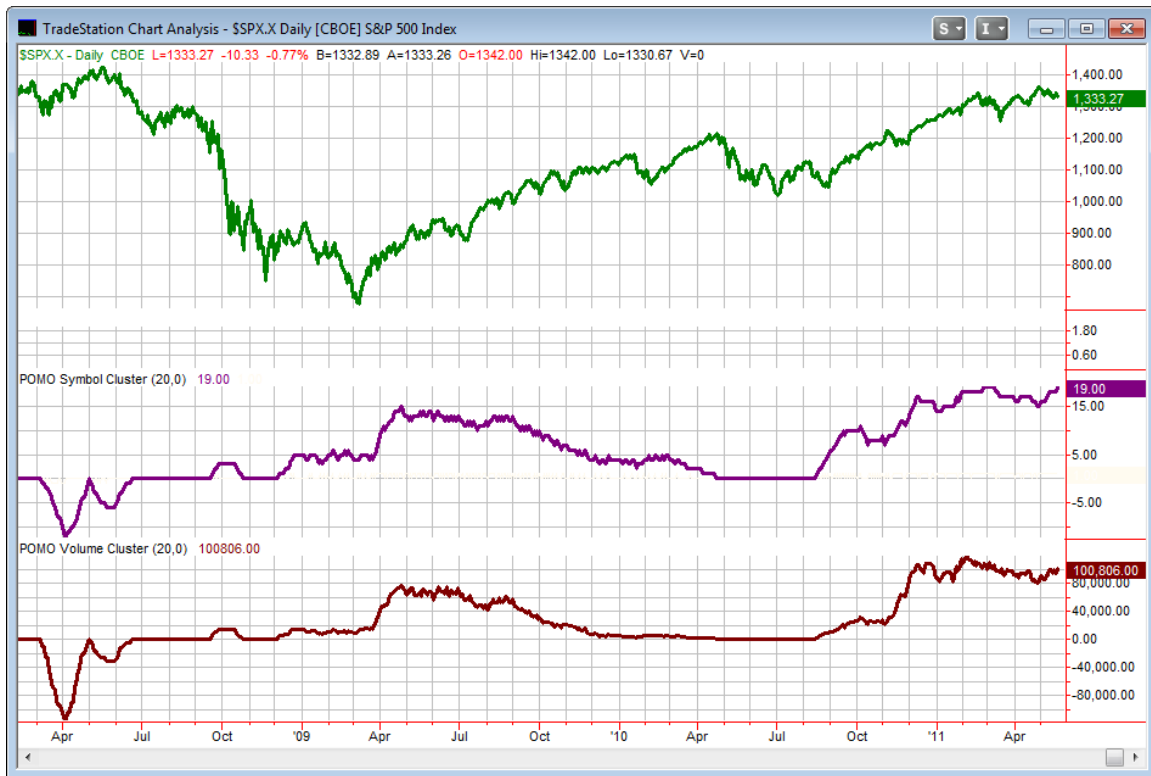


So between the advance/decline line and the decline in new highs breath is somewhat inconclusive. It doesn't appear to be suggesting a significant top is likely, but it does leave open the possibility.

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>



With buying occurring every day this past week both the POMO Days and POMO Volume indicators rose a bit. The liquidity pump continues to inject massive amounts of money into the system and to this point such action has acted as a strong positive influence on the market. Further buying is scheduled to take place Monday-Thursday this week. Friday is an off-day ahead of the long weekend.

For those that would like to view the upcoming schedule through June 10th I have provided a link below.

http://www.newyorkfed.org/markets/tot_operation_schedule.html

The market action has become substantially more choppy than it was a few months ago. We appear to be in a short-term downtrend over the last 3 weeks. Whether it turns into something more is unclear at this point. There is currently more evidence supporting new highs than there is suggested a prolonged downtrend. As usual, I'm willing to trade either side if a strong risk/reward opportunity presents itself. I'll continue to prefer long trades, but have already begun taking them with a bit less aggression.

Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

Open Catapult Triggers

New

GS – 1/3 position @ \$134.99 limit

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 1(GS)

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.

GS – buy 1/3 position @ \$134.99 limit. This is from the Catapult section above. There haven't been any Catapult trades in a while. I would encourage traders who are new to Catapults to view the Catapult & CBI presentation in the videos section of the website before you consider trading them.

SPY – buy 1/4 index position @ \$133.61 limit. Based on short-term outlook above. I have some concern that the SPX is still in the middle of its recent range and may be headed down to test its lows. I strongly considered placing the buy order with a \$133.20 limit. This would have put it down near the 5/16 and 5/17 closing prices. Ultimately I decided since this is just the 1st lot, and there is an apparent upside edge, that I shouldn't get too fancy with the entry. So I placed it at Friday's close. Conservative traders could consider trying for a lower entry.

There are also a few stocks and ETFs on the triggers list that looked appealing. I don't normally like to put too many into one letter but if you're looking for ideas beyond GS and SPY you may want to look there.

Current Open Trade Ideas

none

This report has been prepared by Hanna Capital Management, LLC and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy securities. While information contained herein is believed to be accurate at the time of publication, we make no representation as to the accuracy or completeness of any data, studies, or opinions expressed and it should not be relied upon as such. Robert Hanna, Hanna Capital Management, LLC or clients of Hanna Capital Management, LLC may have positions or other interests in securities (including derivatives) directly or indirectly which are the subject of this report. This report is provided solely for the information of Hanna Capital Management, LLC clients and prospects who are expected to make their own investment decisions without reliance upon this report. Neither Hanna Capital Management, LLC nor any officer or employee of Hanna Capital Management, LLC accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report may not be reproduced, distributed or published by any recipient for any purpose without the prior express consent of Hanna Capital Management, LLC.

Copyright © 2011 Hanna Capital Management, LLC.