

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 24, 2011

Volume 4 Issue 99

Market Overview



Tonight's Research Points

- 2-day pullbacks under current circumstances have often led to more selling the next day.
- Strong selloff on very weak breadth is suggesting a bounce.
- 20-day lows above the 200ma have provided favorable buying opportunities over the last 20 years. The large percent drop on Monday makes the setup even more appealing.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is long.

Short-term Outlook

The Bottom Line

The market got hammered Monday. The studies are generally suggested it shouldn't fall much more, if at all, before rebounding for a few days. 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 24, 2011	2 down & 5-low on Mon. Close > 200ma	1 day	Bearish	
May 24, 2011	SPX dn 1%. Decliners 2x advancers	1-9 days	Bullish	3.05%
May 24, 2011	20-day low & > 200ma. Big drop in 10.	1-7 days	Bullish	2.35%
May 18, 2011	SPY gap down and partial reverse up.	1-5 days	Bullish	1.90%
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 23, 2011	Down Fri op-ex / unfilled gap	1 day	Bullish	

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

The Evidence

Overseas struggles got the market off to a tough start and it never improved much all day. The SPX lost 1.2%, the Nasdaq closed down 1.6% and the Russell 2000 dropped 1.8%. Breadth was also quite negative as you'd expect. The NYSE Up Issues % came in at 21%, and the Up Volume % was just over 10%. Total volume declined a bit from Friday's level.

There were a few studies worth looking at tonight. Most were bullish. I'll get to them but let's first show the one bearish study. It was last seen in the May 17th subscriber letter just a week ago. I have pasted an excerpt from that letter below. (All results are updated.)

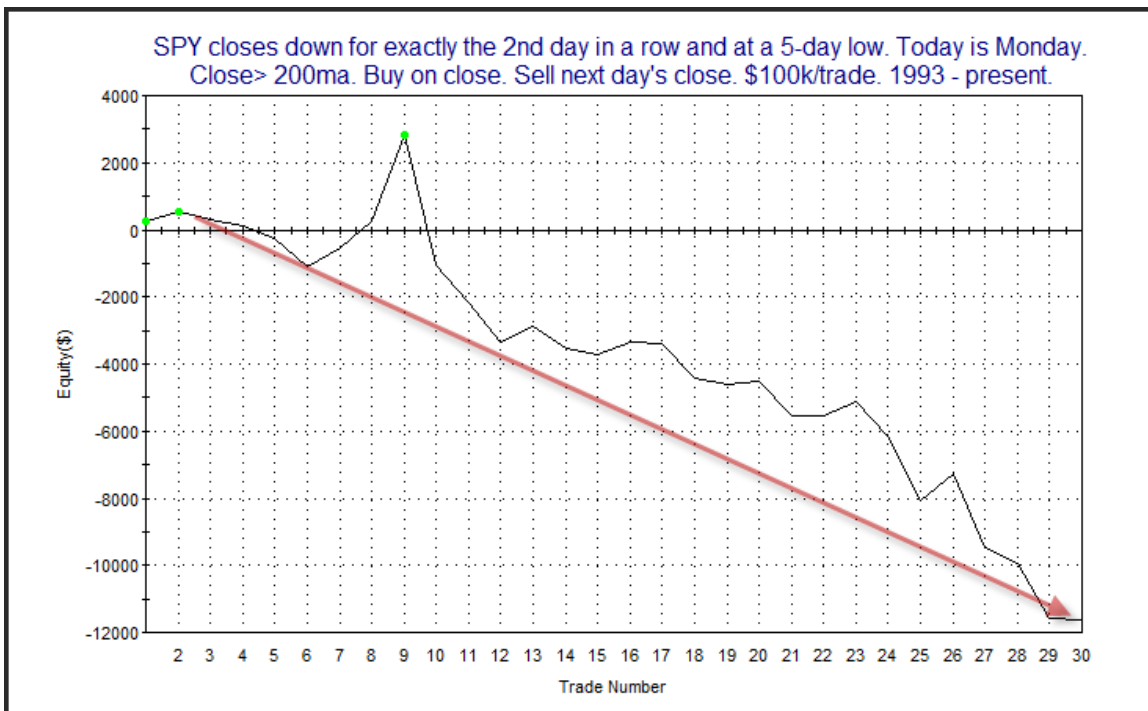
Tuesdays are renowned for short-term trend reversals. I discussed this in the [1/13/09 Blog](#) and I've shown it a number of times since using different filters. I've shown for instance that a 3-day pullback going in to a Tuesday during a long-term uptrend shows a strong chance of a move up over the next few days.

So Monday afternoon I took a look at 2-day drops above the 200ma on a Monday. Results were choppy and unremarkable. I then added one more filter in that the SPY had to close at a 5-day low. I was surprised by the results.

SPY closes down for exactly the 2nd day in a row and at a 5-day low. Today is Monday.
Close > 200ma. Buy on close. Sell next day's close. \$100k/trade. 1993 - present.

TradeStation Performance Summary		Collapse ^	
All Trades			
Total Net Profit	(\$11,613.63)	Profit Factor	0.36
Gross Profit	\$6,570.43	Gross Loss	(\$18,184.06)
Total Number of Trades	30	Percent Profitable	33.33%
Winning Trades	10	Losing Trades	20
Even Trades	0		
Avg. Trade Net Profit	(\$387.12)	Ratio Avg. Win:Avg. Loss	0.72
Avg. Winning Trade	\$657.04	Avg. Losing Trade	(\$909.20)
Largest Winning Trade	\$2,539.68	Largest Losing Trade	(\$3,870.38)

It appears that under these conditions, Tuesdays do NOT provide an upside edge. In fact, there appear to be bearish implications with the setup. Below is an equity curve to see how it has played out over time.



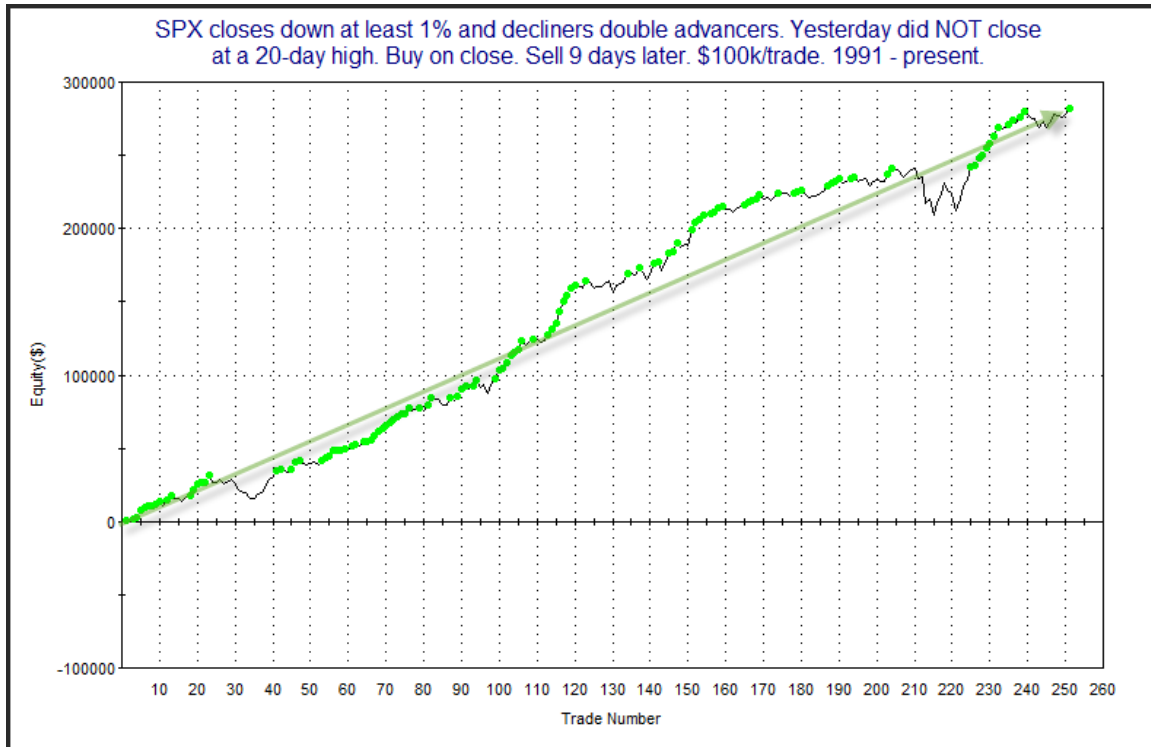
The last 21 instances, since 1998, have been especially negative, with 16 losing Tuesdays versus just 5 winners.

One bullish study that appeared in the Quantifinder is the one below, which was last seen in the 4/19/11 Subscriber Letter. I have updated the results to present.

SPX closes down at least 1% and decliners double advancers. Yesterday did NOT close at a 20-day high. Buy on close. Sell X days later. \$100k/trade. 1991 - 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	241,510.91	241	157	84	65.15	2,987.50	-2,708.65	1.10	2.06	1,002.12
9	282,502.64	251	175	76	69.72	2,818.00	-2,771.69	1.02	2.34	1,125.51
8	251,496.28	265	175	89	66.04	2,798.69	-2,677.25	1.05	2.06	949.04
7	236,778.28	284	177	107	62.32	2,649.31	-2,169.62	1.22	2.02	833.73
6	215,777.13	299	187	112	62.54	2,519.89	-2,280.74	1.10	1.84	721.66
5	203,796.38	325	197	128	60.62	2,329.10	-1,992.47	1.17	1.80	627.07
4	160,835.24	347	203	144	58.50	2,128.51	-1,883.70	1.13	1.59	463.50
3	166,467.69	381	236	145	61.94	1,817.69	-1,810.39	1.00	1.63	436.92
2	158,043.10	434	247	187	56.91	1,709.49	-1,412.84	1.21	1.60	364.15
1	114,866.59	487	289	198	59.34	1,135.97	-1,077.93	1.05	1.54	235.87

85 % of instances posted a close above the entry price at some point in the next 5 days.

Prior to the Crash of '87, very weak breadth days were often followed by more weakness. This changed after the crash. This is the reason that I only run this test back until just after the crash. As you can see there have been a large number of instances over the last 23 years. The edge appears to be very solid as well. Below is the equity curve using a 9-day exit.



While there have been some brief dips the equity curve has been incredibly steady for such a common setup over such a long period. You'll also notice the green dot at the top of the chart indicates it is again hitting new equity highs.

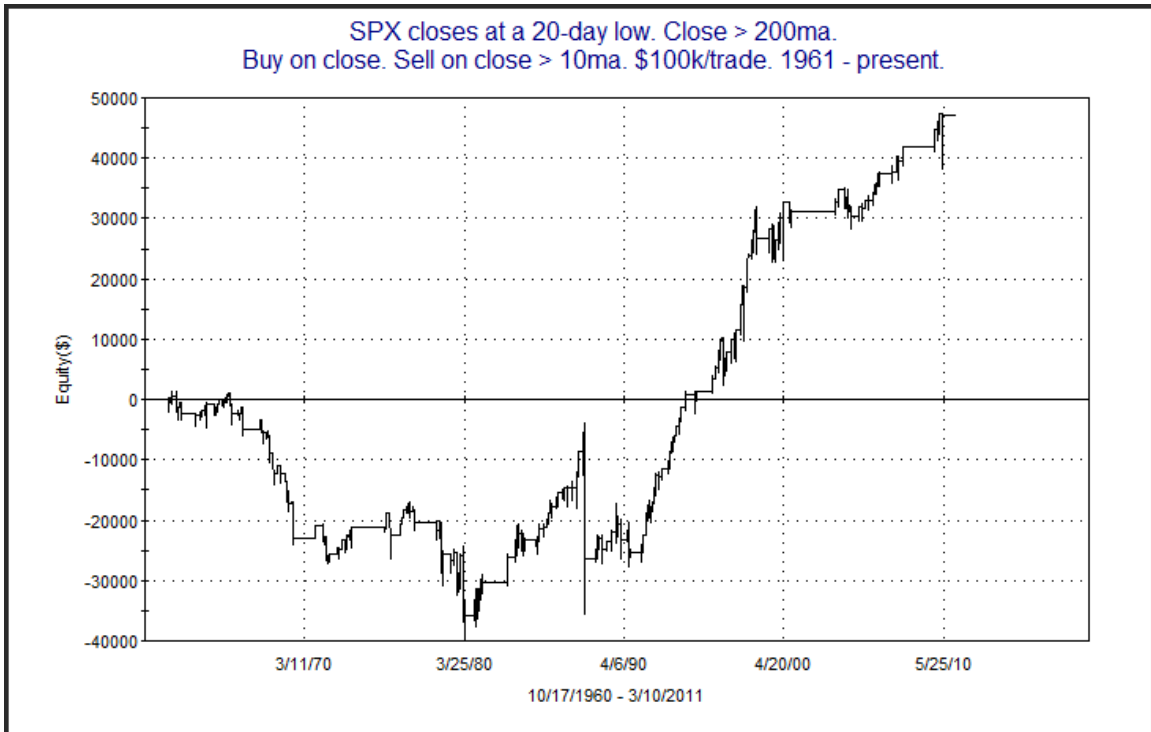
But perhaps the most interesting studies came from the 3/11/11 Subscriber Letter. Below is an excerpt from that letter. Unless otherwise noted, all results are updated.

I also noted that (the SPX) closed at the lowest level in a month. Over the last 20 years or so 1-month lows have provided favorable entry points during long-term uptrends. This can be seen in the table below.

SPX closes at a 20-day low. Close > 200ma.
Buy on close. Sell X days later. \$100k/trade. 1991 - 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	71,733.44	76	51	25	67.11	2,318.42	-1,860.23	1.25	2.54	943.86
9	80,130.15	76	54	22	71.05	2,173.22	-1,691.98	1.28	3.15	1,054.34
8	83,474.76	80	56	24	70.00	2,222.68	-1,708.14	1.30	3.04	1,043.43
7	86,933.84	82	59	23	71.95	2,071.93	-1,535.21	1.35	3.46	1,060.17
6	73,424.54	84	55	29	65.48	2,036.33	-1,330.12	1.53	2.90	874.10
5	63,095.38	90	53	37	58.89	1,875.62	-981.41	1.91	2.74	701.06
4	39,218.22	97	58	39	59.79	1,482.83	-1,199.63	1.24	1.84	404.31
3	42,848.29	110	70	40	63.64	1,261.41	-1,136.26	1.11	1.94	389.53
2	40,922.81	127	80	47	62.99	1,044.84	-907.76	1.15	1.96	322.23
1	22,347.21	174	108	65	62.07	790.95	-970.39	0.82	1.35	128.43

The stats here all seem to suggest an upside edge over the next 1-2 weeks. While this has held true over the last 20 years, it has not always been true. Below is an equity curve of a strategy that would buy these 1-month lows and then exit on a close above the 10-day moving average. (Not updated.)



This appears to be a great strategy over the last 20 years, but a lousy one prior to that. Below are some of the performance stats if we just concern ourselves with the last 20

years. (I'm inclined to do just that since there does not appear to be any indication of the edge deteriorating.)

SPX closes at a 20-day low. Close > 200ma. Buy on close. Sell on close > 10ma. \$100k/trade. 1991 - present.			
TradeStation Performance Summary			Collapse ↕
All Trades			
Total Net Profit	\$72,814.03	Profit Factor	5.05
Gross Profit	\$90,801.47	Gross Loss	(\$17,987.44)
Total Number of Trades	76	Percent Profitable	80.26%
Winning Trades	61	Losing Trades	15
Even Trades	0		
Avg. Trade Net Profit	\$958.08	Ratio Avg. Win:Avg. Loss	1.24
Avg. Winning Trade	\$1,488.55	Avg. Losing Trade	(\$1,199.16)
Largest Winning Trade	\$4,277.94	Largest Losing Trade	(\$4,099.04)
Max. Consecutive Winning Trades	19	Max. Consecutive Losing Trades	3
Avg. Bars in Winning Trades	6.08	Avg. Bars in Losing Trades	11.93
Avg. Bars in Total Trades	7.24		

The winning percentage and profit factor are both very impressive and the average trade nets nearly 1%. Of course there were some characteristics of today's selling that I thought were also worth examining. The market didn't just close at a 20 day low. It did so while undergoing a strong selloff today. Strong selloffs can be defined a number of ways. One way to do so would be to simply compare the price drop to other recent days. Below I reran the strategy and added the requirement that today's percent drop must be the largest in the last 10 days.

SPX closes at a 20-day low. Close > 200ma. Today's loss is the largest in 10 days.
Buy on close. Sell on close > 10ma. \$100k/trade. 1991 - present.

TradeStation Performance Summary				Collapse
All Trades				
Total Net Profit	\$70,192.56	Profit Factor	9.82	
Gross Profit	\$78,155.16	Gross Loss	(\$7,962.60)	
Total Number of Trades	53	Percent Profitable	84.91%	
Winning Trades	45	Losing Trades	8	
Even Trades	0			
Avg. Trade Net Profit	\$1,324.39	Ratio Avg. Win:Avg. Loss	1.74	
Avg. Winning Trade	\$1,736.78	Avg. Losing Trade	(\$995.32)	
Largest Winning Trade	\$7,070.28	Largest Losing Trade	(\$3,275.60)	
Max. Consecutive Winning Trades	19	Max. Consecutive Losing Trades	1	
Avg. Bars in Winning Trades	6.33	Avg. Bars in Losing Trades	10.88	
Avg. Bars in Total Trades	7.02			

Results here are even stronger than the first test. The profit factor nearly doubles to almost 10, the percent profitable reaches nearly 85%, and the average trade gains over 1.3%.

I would also note that while the “large loss” filter eliminated about 1/3 of the trades, total net profit was almost the same. This strongly suggests it is a worthwhile filter. Below I show the results of this setup using a time-based exit.

SPX closes at a 20-day low. Close > 200ma. Today's loss is the largest in 10 days. Buy on close. Sell X days later. \$100k/trade. 1991 - 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	52,360.96	51	35	16	68.63	2,370.61	-1,913.15	1.24	2.71	1,026.69
9	65,512.79	52	40	12	76.92	2,119.35	-1,605.10	1.32	4.40	1,259.86
8	62,929.24	52	37	15	71.15	2,343.92	-1,586.39	1.48	3.64	1,210.18
7	74,955.72	53	42	11	79.25	2,215.13	-1,643.61	1.35	5.15	1,414.26
6	69,329.23	53	40	13	75.47	2,216.01	-1,485.46	1.49	4.59	1,308.10
5	58,131.97	53	33	20	62.26	2,264.47	-829.78	2.73	4.50	1,096.83
4	38,878.35	55	35	20	63.64	1,773.51	-1,159.72	1.53	2.68	706.88
3	32,297.19	55	38	17	69.09	1,406.87	-1,244.93	1.13	2.53	587.22
2	32,548.41	56	38	18	67.86	1,249.54	-829.66	1.51	3.18	581.22
1	14,317.54	58	39	19	67.24	740.60	-766.62	0.97	1.98	246.85

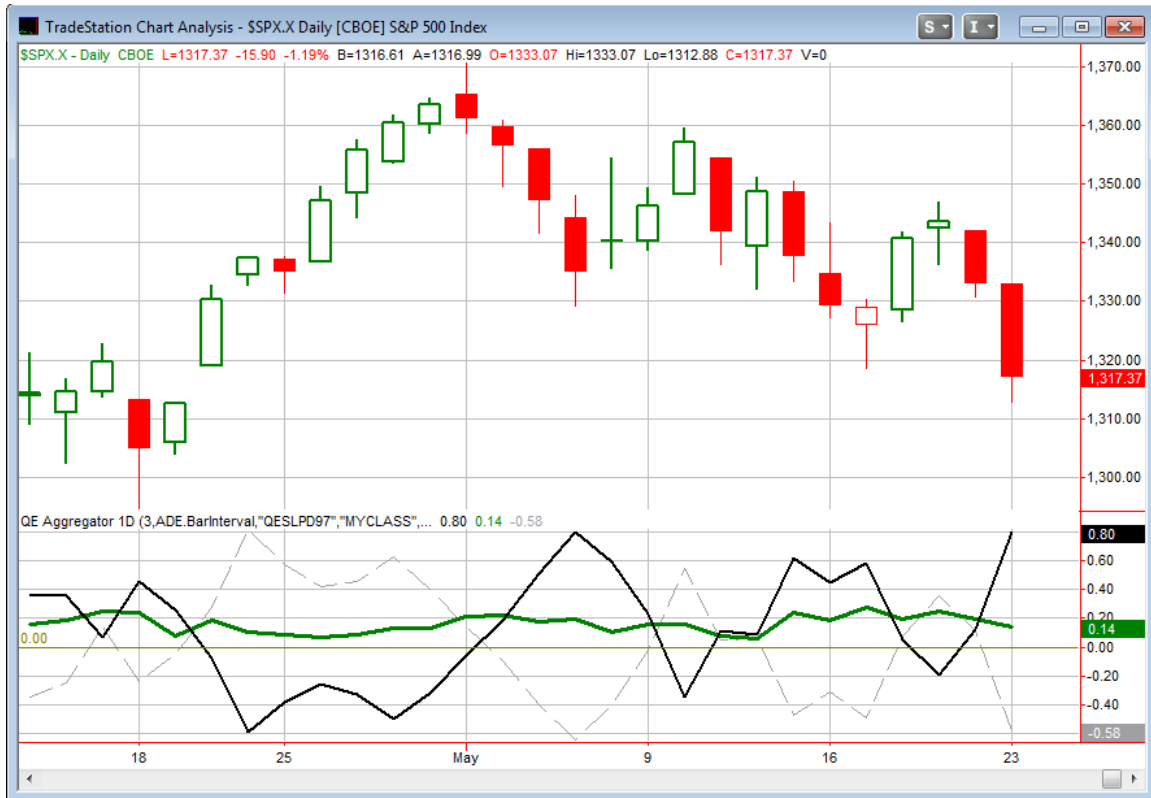
In the 3/11 letter I also looked at using NYSE volume as a filter. It appeared that it may make a difference based on some of those results. I examined this further today and

looked across about 200 stocks and ETFs. There was no identifiable advantage to instituting a volume filter. So I didn't worry about that tonight.

Note on new numbered system

When I last looked at this setup I was so impressed with the results that I thought it might make a decent addition to the "numbered systems". Today I spent a good amount of time examining the results across the S&P 100 and the ETF list. Results on its own were impressive. But when combined with an Aggregator long signal the results over the last few years appeared to be very strong. I've numbered this system 110524 and added a whole new page complete with rules, results, and code. As you'll see when looking at the triggers spreadsheet tonight, a good number of securities triggered 110524. I listed one of those to be tracked in the Trade Ideas section further down. 110524 should help to identify more trading opportunities for numbered systems traders going forward. I will hold a brief webinar to discuss the system and answer any questions in the near future.

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



The green Aggregator Line remained strongly above 0 again tonight. 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 spike higher again today. It is now as stretched as it has been at any time recently since the 5/5/11 low. Readings above 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 suggested an upside edge. It can be seen on the chart whenever both lines close above 0. Due to this the Aggregator System remained flat at the close.

The green Aggregator line is again set to close above 0 on Tuesday. This could change if strong bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,352.78. This is about 2.7% above Monday's close. So it would take a very large 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.

I was able to get some partial long positions established on Monday. It will look to add more exposure on Tuesday. Details in the trade ideas section below.

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.

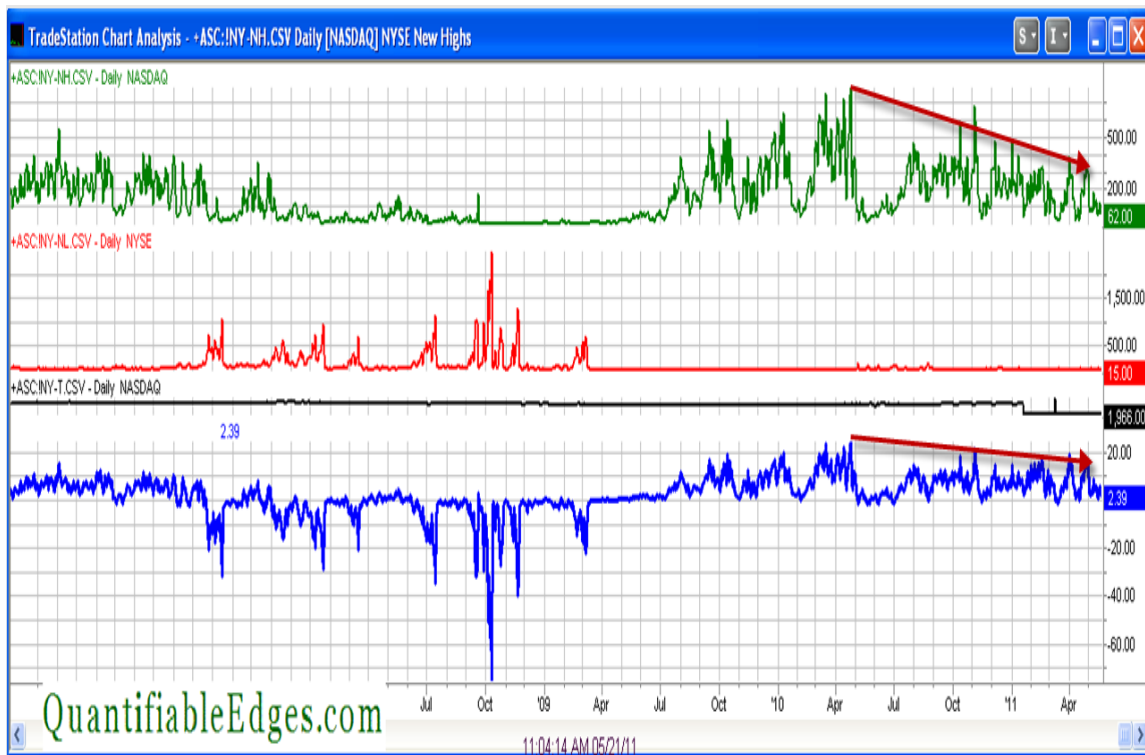
So are we seeing a mini move down, or is this the start of something big?

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.



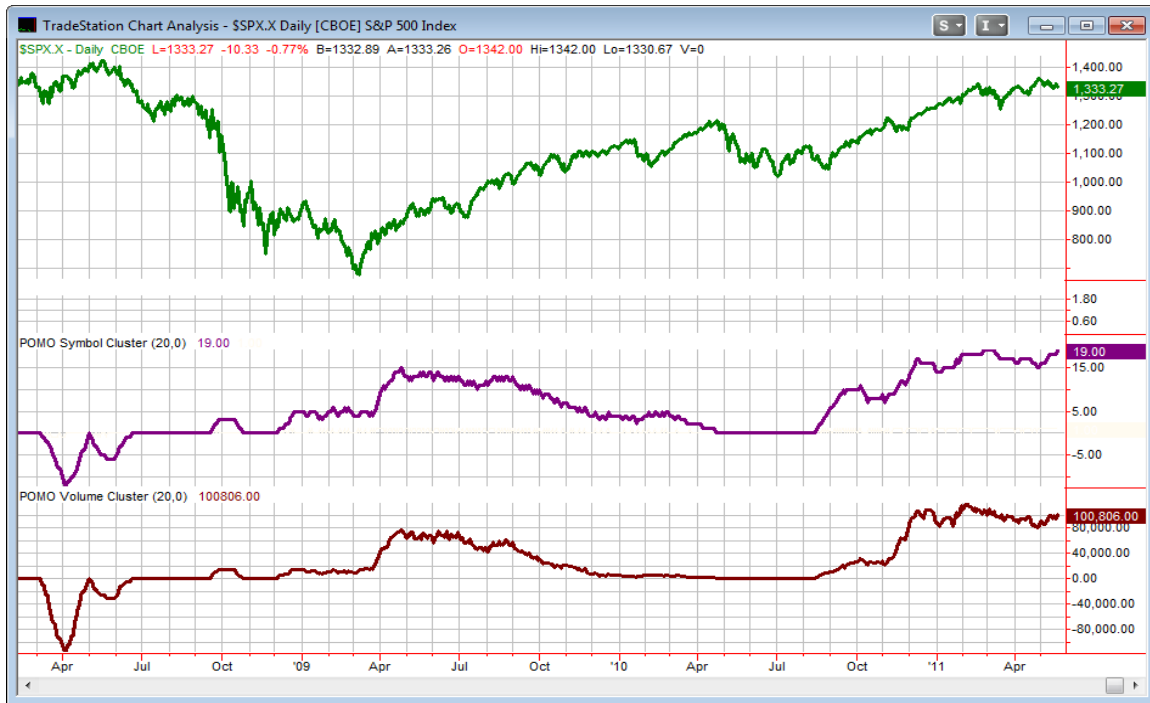
So between the advance/decline line and the decline in new highs breath is somewhat inconclusive. It doesn't appear to be suggesting a significant top is likely, but it does leave open the possibility.

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

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.

EWU – buy @ \$17.76 limit. This is based on system 110524. I thought I might as well track a trigger based on the new system. EWU looked as good as any to me.

SPY – buy 1/4 index position @ \$131.00 limit ON CLOSE. Based on short-term outlook above. The edge appears to be for upside over the next few days. If the market sells off a bit more on Tuesday I'll look to take a 2nd lot of my index position at the close.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	5/23/2011	\$131.98	\$132.06	0.06%		bought on open
GS(1/3)	5/23/2011	\$133.64	\$135.84	1.65%		bought on open

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