

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 9, 2012

Volume 5 Issue 67

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Long	100% Long XIV	Flat	Long

Tonight's Research Points

- 3-day pullbacks under similar conditions in the past suggested a substantial upside edge.
- POMO flows will be weak for the rest of the month.

Short-term Outlook

The Bottom Line

There still appears to be a sizable upside edge. I am partially long and looking to possibly get longer.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
April 9, 2012	3 Down from int-term hi w/bull factors	1-3 days	Bullish	1.85%
April 5, 2012	50-day high to 8-day low in 2 days	1-4 days	Bullish	1.60%
April 3, 2012	NDX up > 1%. SOX down.	1-6 days	Bearish	-3.20%
April 2, 2012	1st Week In April & Holy Thurs Seasonl	1-4 days	Bullish	2.10%
April 2, 2012	SPX 3-day high. Nas/Rus down 3 days.	1-10 days	Bullish	4.30%
March 23, 2012	3-day pullback from 50-high	1-6 days	Bullish	2.60%
Active - Long Term				
March 14, 2012	SPX & TNX hit 50-day highs	1-50 days	Bearish	
March 14, 2012	50-day high on strong breadth	1-50 days	Bullish	8.00%
March 5, 2012	Negative breadth divergences	int term	Bearish	
February 1, 2012	Golden Cross	int term	Bullish	
January 17, 2012	Nasdaq leading SPX	int term	Bullish	
December 5, 2011	POMO activity flat to negative	int term	Bearish	
Dropped Tonight				
April 3, 2012	VIX up SPX up 2x & 50-day high.	1-3 days	Bearish	-1.30%

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

The Evidence

Thursday saw the market open weak, bounce back quickly, and then spend the afternoon quietly consolidating. The net result was mixed. The SPX fell 0.1% and the Russell declined 0.3% but the NASDAQ was able to manage a 0.4% gain. Breadth was squarely negative as the NYSE Up Issues % came in at 42% and the Up Volume % was 32%. Total NYSE volume came in very light with many traders likely cutting out early.

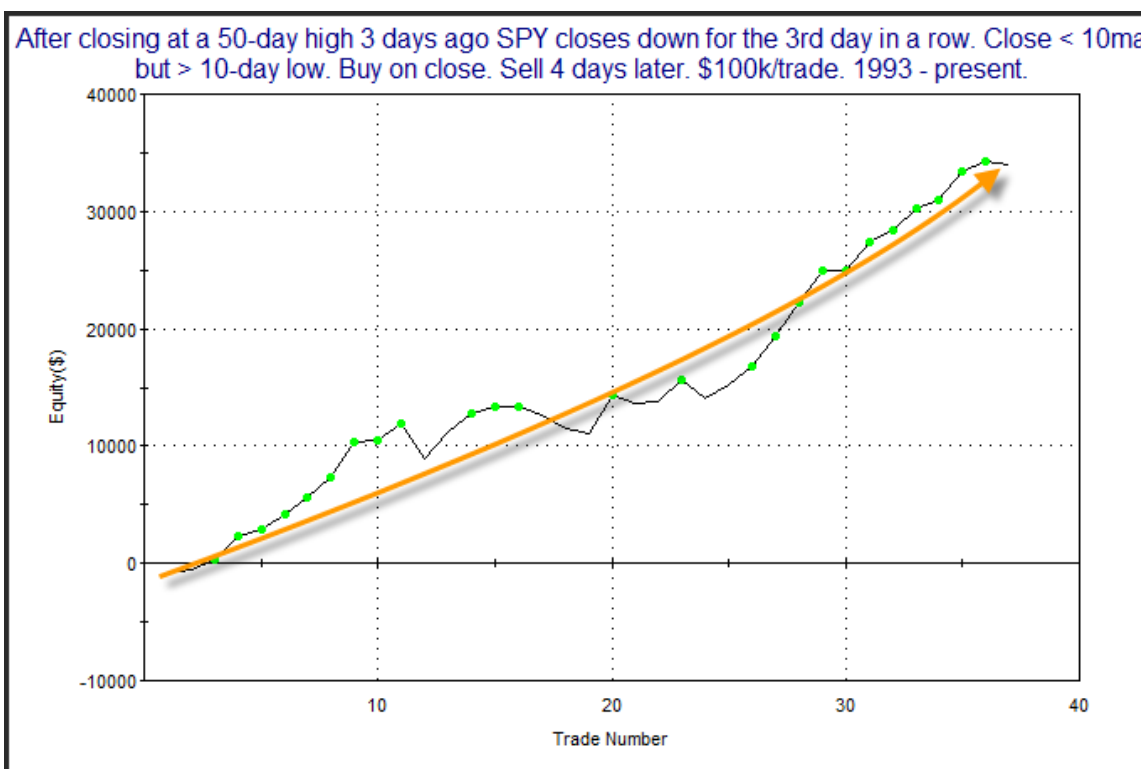
The 3-day pullback attracted a few Quantifinder studies tonight. While a 3-day drop will often lead to an upside edge, they aren't all created equal. Certain standout characteristics that I've identified over the years tend to raise (or lower) the chances of a bounce actually occurring. Based on what I am seeing with this one, the odds appear pretty favorable. Some important aspects of this pullback include: 1) It is occurring during a long-term uptrend. 2) It is coming off an intermediate-term high. 3) The decline is slowing and was very mild this last day. 4) It is below its short-term (10-day) moving average. So I perused the list of studies and elected to review the two below. I felt they best represented the current market conditions.

This first one is one that has been seen a few times recently. It was last shown in the 3/30/12 Letter. I have updated the stats table below.

After closing at a 50-day high 3 days ago SPY closes down for the 3rd day in a row. Close < 10ma but > 10-day low. 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: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	46,867.16	36	26	10	72.22	2,564.10	7,242.70	-1,979.95	-6,933.13	1.30	3.37	1,301.87
9	38,614.72	36	27	9	75.00	2,284.06	6,322.56	-2,561.67	-8,192.92	0.89	2.67	1,072.63
8	43,411.15	36	28	8	77.78	2,182.09	6,358.08	-2,210.92	-4,499.25	0.99	3.45	1,205.87
7	39,629.46	36	27	9	75.00	2,107.12	6,322.56	-1,918.08	-4,354.31	1.10	3.30	1,100.82
6	41,652.82	36	27	9	75.00	2,001.51	5,375.36	-1,376.44	-2,140.14	1.45	4.36	1,157.02
5	31,840.46	37	26	11	70.27	1,701.39	3,522.94	-1,126.87	-3,453.71	1.51	3.57	860.55
4	34,020.13	37	29	8	78.38	1,468.12	3,178.14	-1,069.43	-3,076.63	1.37	4.98	919.46
3	21,846.04	37	25	12	67.57	1,352.56	2,873.85	-997.32	-2,027.68	1.36	2.83	590.43
2	12,181.20	37	25	12	67.57	1,029.71	2,332.48	-1,130.14	-2,379.48	0.91	1.90	329.22
1	7,557.68	37	22	15	59.46	872.60	2,060.16	-775.96	-2,031.09	1.12	1.65	204.26

Under these circumstances, it appears bounces have been both reliable and powerful. Below is a look at the profit curve assuming a 4-day exit technique.



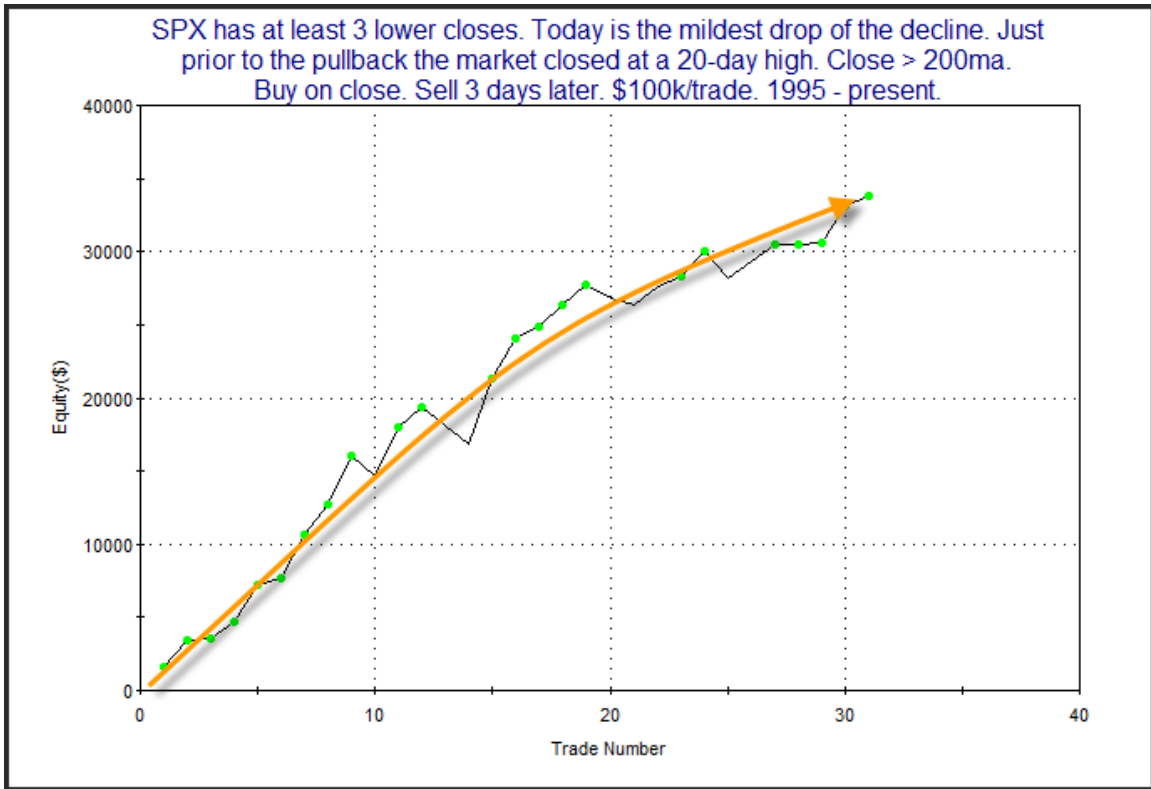
The curve appears to provide confirmation of the bullish tendency suggested by the stats table.

This next study was last seen in the 7/13/11 Subscriber Letter. It takes into account the fact that today's drop was the smallest of the bunch. This can suggest the sellers are running out of steam. I shortened the lookback period a little bit and re-ran the stats below.

SPX has at least 3 lower closes. Today is the mildest drop of the decline. Just prior to the pullback the market closed at a 20-day high. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1995 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	44,321.34	29	23	6	79.31	2,373.15	7,183.08	-1,710.18	-7,026.10	1.39	5.32	1,528.32
9	43,195.19	29	23	6	79.31	2,353.85	6,685.72	-1,823.90	-7,816.60	1.29	4.95	1,489.49
8	41,521.91	29	23	6	79.31	2,257.83	6,017.68	-1,734.68	-4,389.40	1.30	4.99	1,431.79
7	35,766.33	30	21	9	70.00	2,306.37	6,121.80	-1,407.50	-3,690.70	1.64	3.82	1,192.21
6	35,453.59	30	20	10	66.67	2,107.42	5,533.56	-669.48	-1,803.70	3.15	6.30	1,181.79
5	33,362.90	31	23	8	74.19	1,884.15	5,769.16	-1,246.56	-3,304.80	1.51	4.35	1,076.22
4	31,064.49	31	19	12	61.29	2,160.00	4,989.40	-831.30	-2,876.40	2.60	4.11	1,002.08
3	33,836.91	31	25	6	80.65	1,641.31	4,373.80	-1,199.32	-1,926.03	1.37	5.70	1,091.51
2	27,308.37	31	25	6	80.65	1,333.90	3,583.44	-1,006.51	-2,502.75	1.33	5.52	880.92
1	13,011.60	34	26	7	76.47	748.31	1,767.00	-920.62	-2,214.00	0.81	3.02	382.69

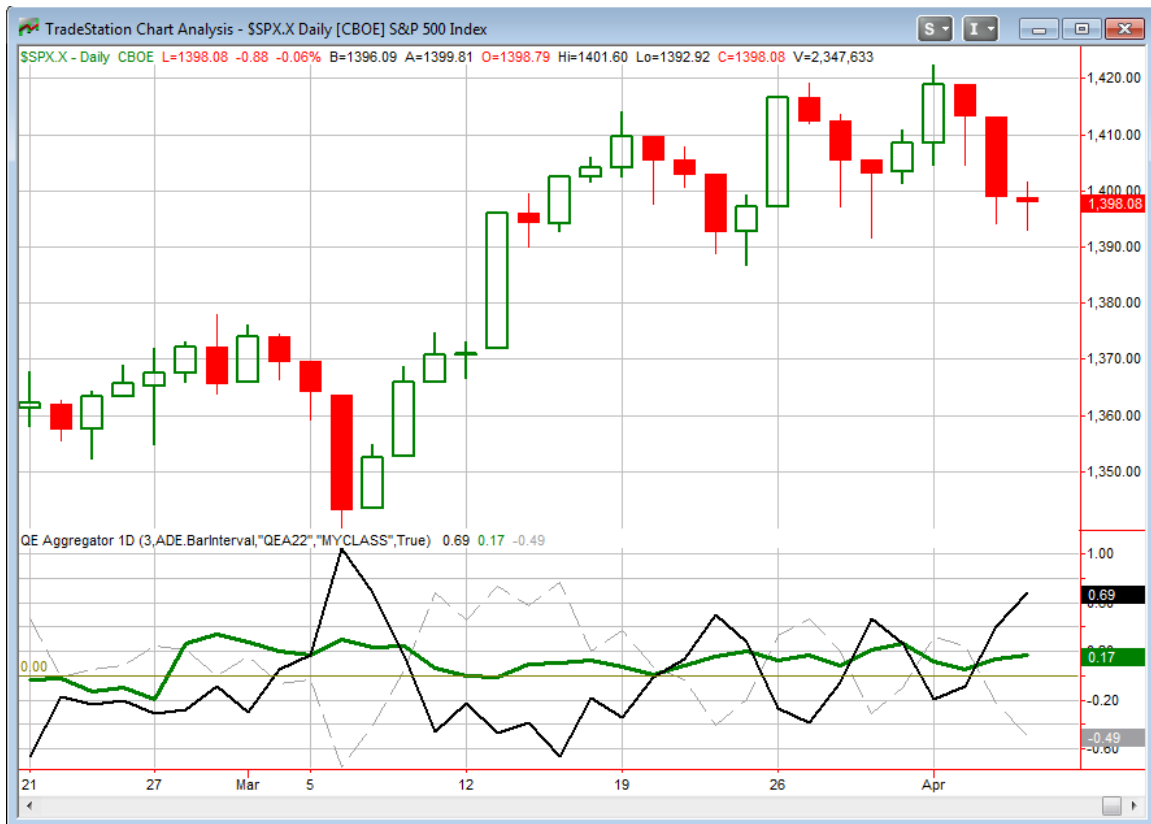
Only 1 instance failed to close above the entry price at some point in the next week. It triggered on 7/22/98.

Here again we see what appears to be a reliable setup with some powerful results. A 3-day profit curve can be found below.



This curve is decelerating a little bit while the previous curve was showing slight acceleration. It still appears solid and worth consideration. As I sometimes do, I elected to average the 2 studies together for purposes of generating expectations.

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



Once again the green Aggregator Line crept further into positive territory. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line is now as far above zero as it has been in a month. A positive Differential reading means the SPX has underperformed expectations over the last few days. So net expectations are squarely bullish and the SPX is strongly overbought versus recent expectations. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. This meant the Aggregator System remained long at the close. This was projected on the systems page before the bell.

Based on the current studies, expectations are scheduled to remain positive on Monday. Of course this could change if strong bearish evidence emerges. Meanwhile, the Differential Pivot will be well above current prices at 1,419.18 on Monday. This is 1.5% above Thursday's close. A rally this strong on Monday isn't too likely. We will probably need to see a multi-day move higher from here to move the market back into oversold territory.

In the Subscriber Letter on Wednesday night I noted that although I was optimistic about the current setup, I was not going to get aggressive ahead of the employment report on Friday. It looks like that will be a good choice since futures moved down over 1% on

Friday after the report was released. Monday will likely start with a large down open. I'll look to take advantage of the discount and add to my long position. This will give me about a ½ size index position. As you'll see below, my intermediate-term outlook is now neutral. A large reason for this is that POMO activity will not be bullish for the rest of the month. With this in mind, it is unlikely I will increase my long position beyond the ½ size unless extremely compelling evidence emerges.

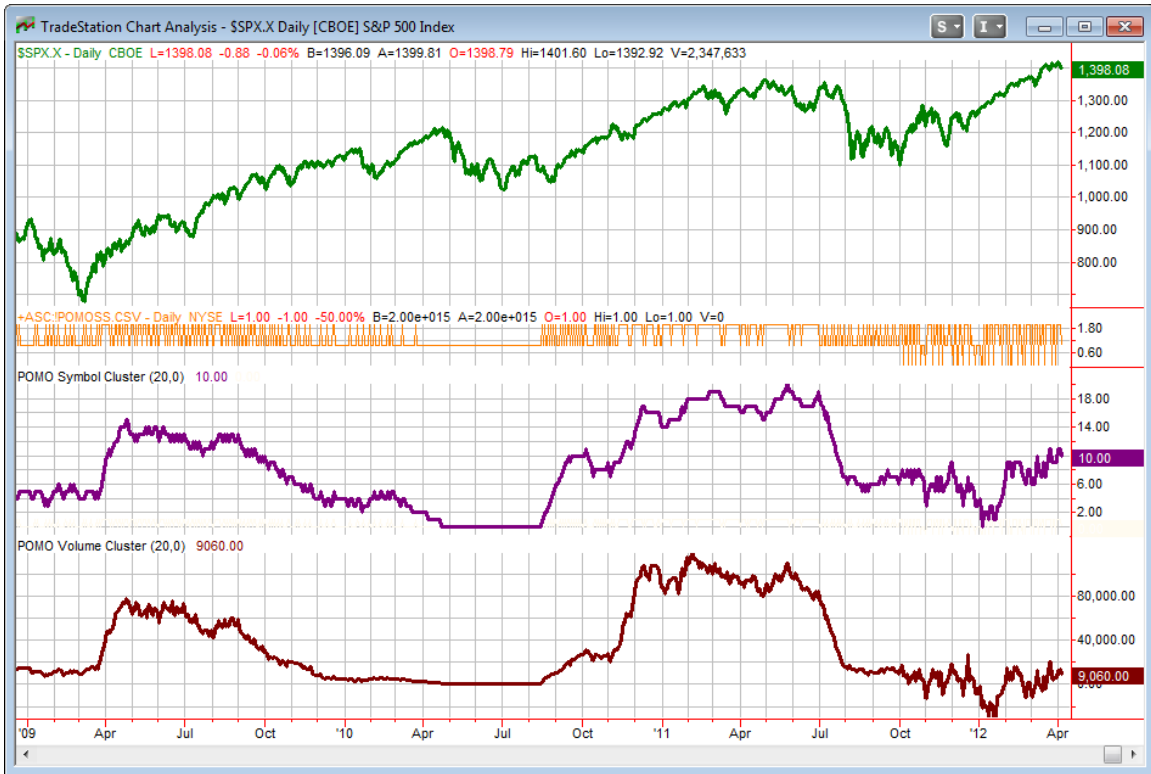
Intermediate-term Outlook (2 weeks – 2 months)– updated 4/9 – neutral

Despite positive seasonality the market failed to make progress in this shortened week. The SPX declined a mild 0.75% from last week's close. This week's action didn't bring about any new intermediate-term edges, but there are still some things to consider.

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 (purple) pane is the net rolling number of days in the last 20 that have been POMO days. In other words, a day the Fed buys on the market will add +1 while a day of selling will count as -1. The bottom pane is the total amount of money infused into (or taken out of) 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.)

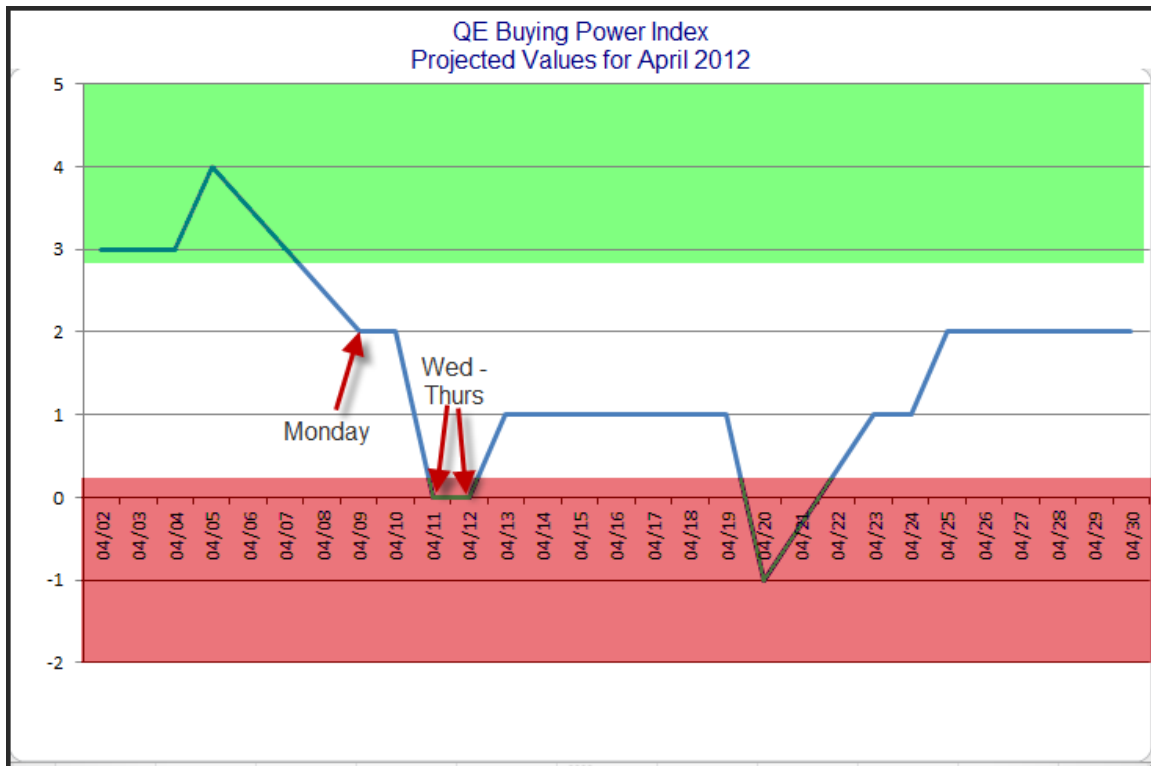
<http://www.quantifiableedges.com/members/pomo.php>



This past week saw strong inflows in the amount of just over \$12.5 billion. This was accomplished with 3 days of buying, and 1 day of inactivity. This kept the intermediate-term POMO indicators near the top of their recent range.

The liquidity flows are about to worsen, though. This upcoming week is scheduled for three days of buying and two days of selling with total net inflows of only about \$1 billion. And over the next three weeks there is expected to be about \$13 billion in net POMO outflows. As I did last week, I think it is worth pointing out the April projected QE Buying Power Index. The chart below is taken from the QE Buying Power Index information page.

<http://www.quantifiableedges.com/members/qebuyingpower.php>



I added a few arrows here to point out what's happening this week. As you can see, Monday the index is set to drop down to "2". Of course "3" or higher is considered bullish. After spending most of March at 3 or above, the index will not see that level again in April. This means the QE Buying Power Swing System cannot trigger long for the rest of the month. There will be a few opportunities for shorts to trigger. The first of those opportunities will be on Wednesday and Thursday of this upcoming week. So if the market does bounce in the early part of this upcoming week as the short-term outlook above suggests is likely, there is a chance it could set up a short trade on either Wednesday or Thursday.

I have continually been surprised at how well the market has performed over the last few months considering the very slight inflows provided by Operation Twist. If the market is going to suffer an intermediate-term pullback, POMO flows suggest it could get going here soon.

Aside from the poor POMO schedule, we also need to be mindful of breadth divergences, and possible negative impacts from rising interest rates. Intermediate-term bullish indicators are still active, but they no longer appear to substantially overwhelm the

bearish ones. I am not calling a top. I do not see a strong intermediate-term downside edge. But I am now wary and no longer excited about the bull case. Therefore I have moved my market outlook to neutral. I am still willing to take both longs and shorts, but I won't get overly aggressive with either.

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.

SPY – buy ¼ index position @ \$139.00 limit. Based on the short-term outlook above. We could get a sizable gap down thanks to the weak jobs report. I'll be a buyer if the gap down is big enough or if SPY dips to this level during the day.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
XIV(1/2)	3/6/2012	\$8.48	\$11.55	36.20%	\$10.40	Aggressive VIX
SPY(1/4)	4/5/2012	\$139.38	\$139.79	0.29%		bought on open

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