

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 12, 2012

Volume 5 Issue 70

Market Overview



Signals Overview

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

Tonight's Research Points

- Mild bounces from strong drops – whether “mild” is determined by price action or volume – suggest an upside edge over the next several days.
- Without backing from POMO, I don't feel the edge is as strong as it typically is.

Short-term Outlook

The Bottom Line

The bounce began on Wednesday and odds favor a continuation over the next few days. I'm still a bit cautious. POMO flows are weak and the CBI is only moderately high.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
April 12, 2012	Low vol bounce after RSI(2)<2.	1-2 days	Bullish	
April 12, 2012	Mild price bounce after 4+ day drop	1 day	Bullish	
April 11, 2012	System 110524	1-7 days	Bullish	2.30%
April 10, 2012	4 down. Biggest drop today. SPX>200ma	1-5 days	Bullish	2.10%
April 10, 2012	Worst breadth & lowest volume 15 days	1-4 days	Bullish	1.90%
April 10, 2012	5 gaps down	1-3 days	Bullish	2.30%
April 2, 2012	SPX 3-day high. Nas/Rus down 3 days.	1-10 days	Bullish	4.30%
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 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%
<i>April 11, 2012</i>	<i>Drop through 50ma on breadth&v</i>	<i>1 day</i>	<i>Bullish</i>	

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

The Evidence

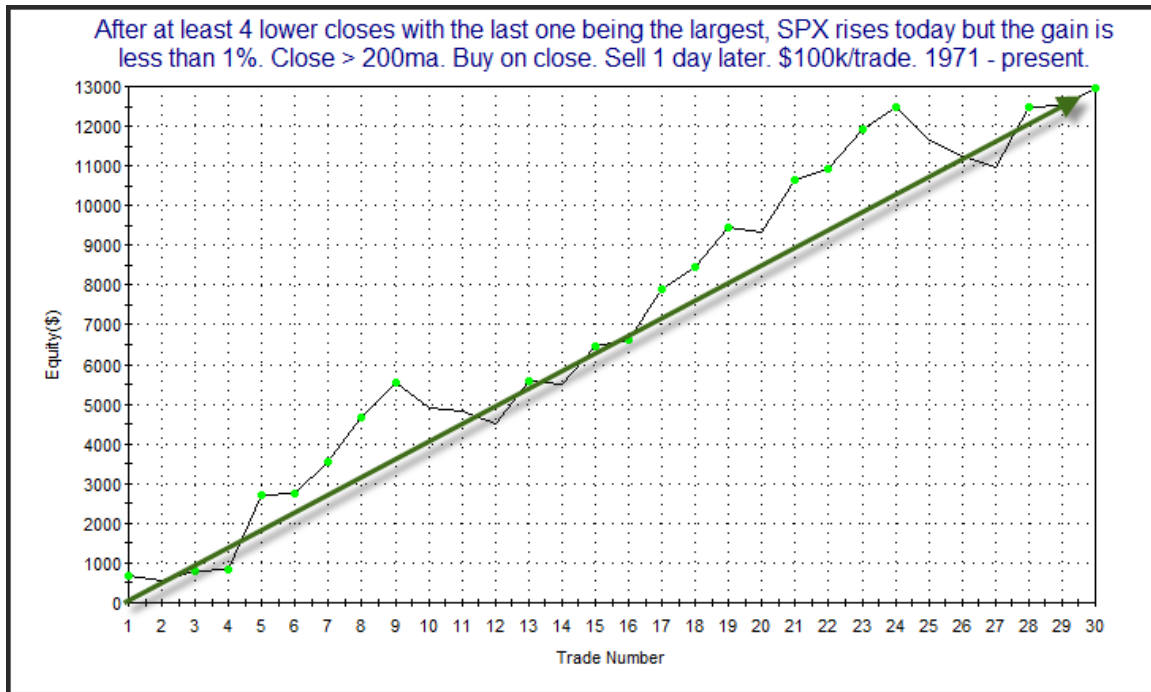
The market enjoyed a bit of a bounce on Wednesday. The SPX rose 0.7%, the NASDAQ gained 0.8%, and the Russell 2000 rallied 1.6%. Breadth was strongly positive as the NYSE Up Issues % came in at 77% and the Up Volume % was 79%. Total NYSE volume dipped from Tuesday's level.

The Quantifinder identified a few studies tonight that were worth examining. The one below is from the 5/9/11 subscriber letter. It looks at what happens when 4+ down days (the last one being the largest) are followed by a moderate bounce. Results below are all updated.

After at least 4 lower closes with the last one being the largest, SPX rises today but the gain is less than 1%. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1971 - 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
5	15,424.29	30	19	11	63.33	1,318.74	2,692.16	-875.62	-1,752.18	1.51	2.60	514.14
4	14,807.17	30	21	9	70.00	980.16	2,948.67	-641.81	-1,854.16	1.53	3.56	493.57
3	9,274.78	30	19	11	63.33	964.91	2,713.95	-823.50	-2,321.70	1.17	2.02	309.16
2	11,584.15	30	19	11	63.33	1,017.66	3,047.41	-704.68	-1,546.60	1.44	2.49	386.14
1	12,957.87	30	21	9	70.00	750.94	1,863.54	-312.43	-835.05	2.40	5.61	431.93

26 of 30 instances (87%) closed above the entry price at some point in the next 3 days.

Over the 1-5 day period there appears to be a bit of an upside edge. Most of the gains were typically realized on day one though. Below is a profit curve that assumes a one day holding period.



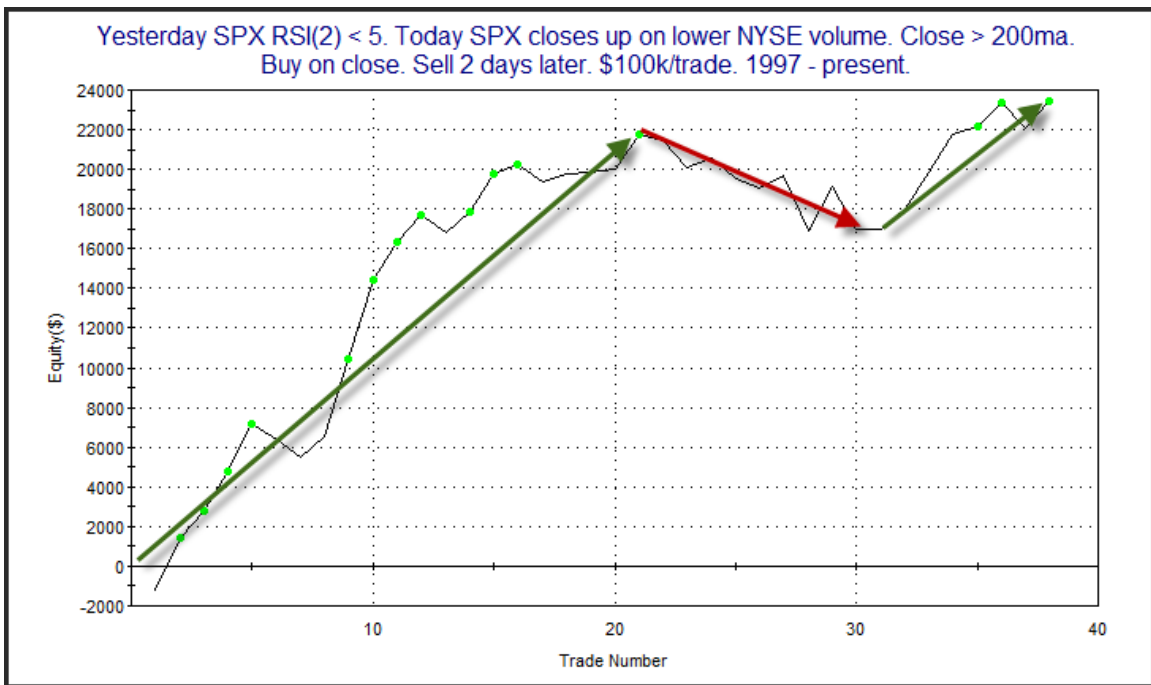
The strong steady upslope acts as confirmation of the upside edge.

Another interesting study from the Quantifinder was last seen in the 3/18/11 subscriber letter. It considered bounces from strongly oversold short-term conditions and filtered based on the relative volume of the first day of the bounce. The study suggested that low volume bounces provide more favorable odds. I have updated the study below.

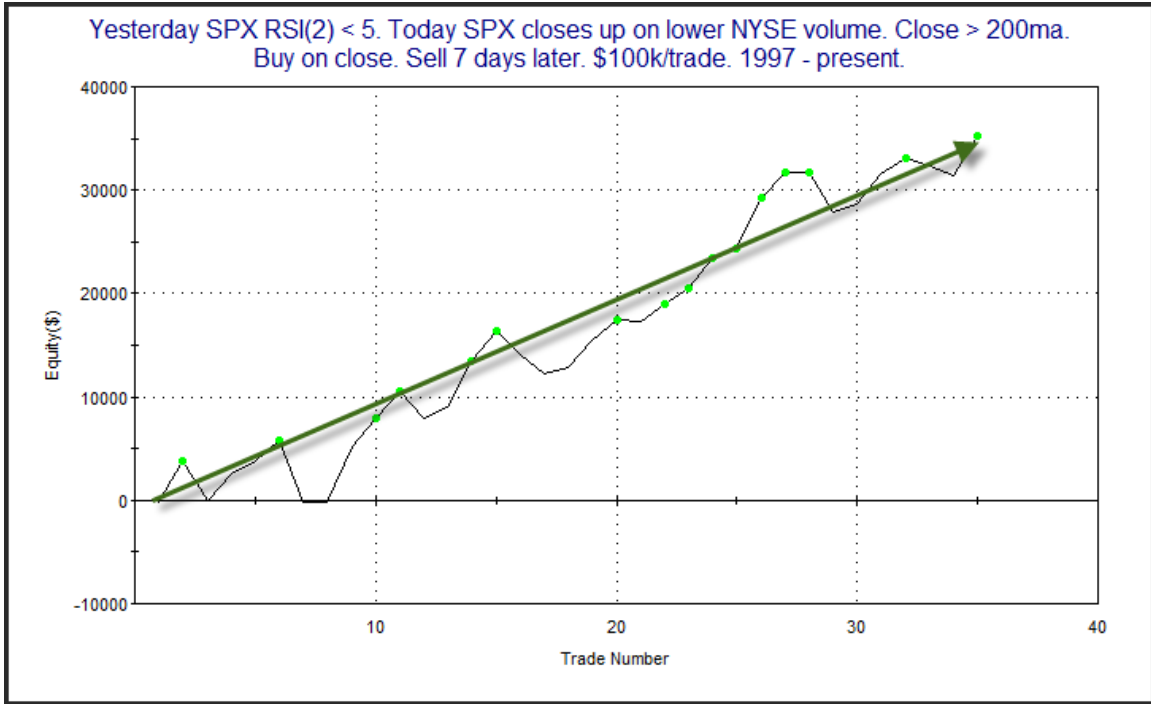
Yesterday SPX RSI(2) < 5. Today SPX closes up on lower NYSE volume. Close > 200ma.
Buy on close. Sell X days later. \$100k/trade. 1997 - present.

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	23,183.71	34	17	17	50.00	3,384.18	6,440.94	-2,020.43	-7,402.88	1.67	1.67	681.87
9	31,175.88	35	23	12	65.71	2,707.35	6,371.46	-2,591.10	-6,195.44	1.04	2.00	890.74
8	21,042.95	35	24	11	68.57	2,250.91	6,486.48	-2,998.07	-7,580.04	0.75	1.64	601.23
7	35,234.27	35	24	11	68.57	2,407.17	5,418.09	-2,048.89	-5,975.16	1.17	2.56	1,006.69
6	31,642.52	36	24	12	66.67	2,154.80	5,668.38	-1,672.71	-3,510.00	1.29	2.58	878.96
5	26,643.80	36	21	15	58.33	2,431.39	5,396.71	-1,627.69	-8,178.56	1.49	2.09	740.11
4	24,294.00	38	23	15	60.53	1,956.49	4,223.34	-1,380.35	-2,736.28	1.42	2.17	639.32
3	17,906.24	38	22	16	57.89	1,575.91	4,457.43	-1,047.74	-3,490.90	1.50	2.07	471.22
2	23,410.52	38	26	12	68.42	1,438.21	4,001.40	-1,165.25	-2,735.64	1.23	2.67	616.07
1	13,434.37	38	25	13	65.79	961.73	2,842.84	-816.07	-2,782.56	1.18	2.27	353.54

The numbers here are all fairly attractive. The 2-day and 7-day results appeared to be especially appealing. Below are profit curves for both those time frames. First I will show the 2-day holding period.



This one saw a bit of a stumble in the middle of the curve, but now appears to be back on track. That is a little disconcerting, but not so much to make me throw out the study. I also wanted to look at the 7-day results.



This curve is more appealing. It did not seem to suffer the same struggles that the 2-day holding period experienced.

The volume is an interesting filter here. Many readers may be wondering whether it really matters. The test below looks at the exact same scenario, except rather than requiring volume come in lower, it requires it to come in higher.

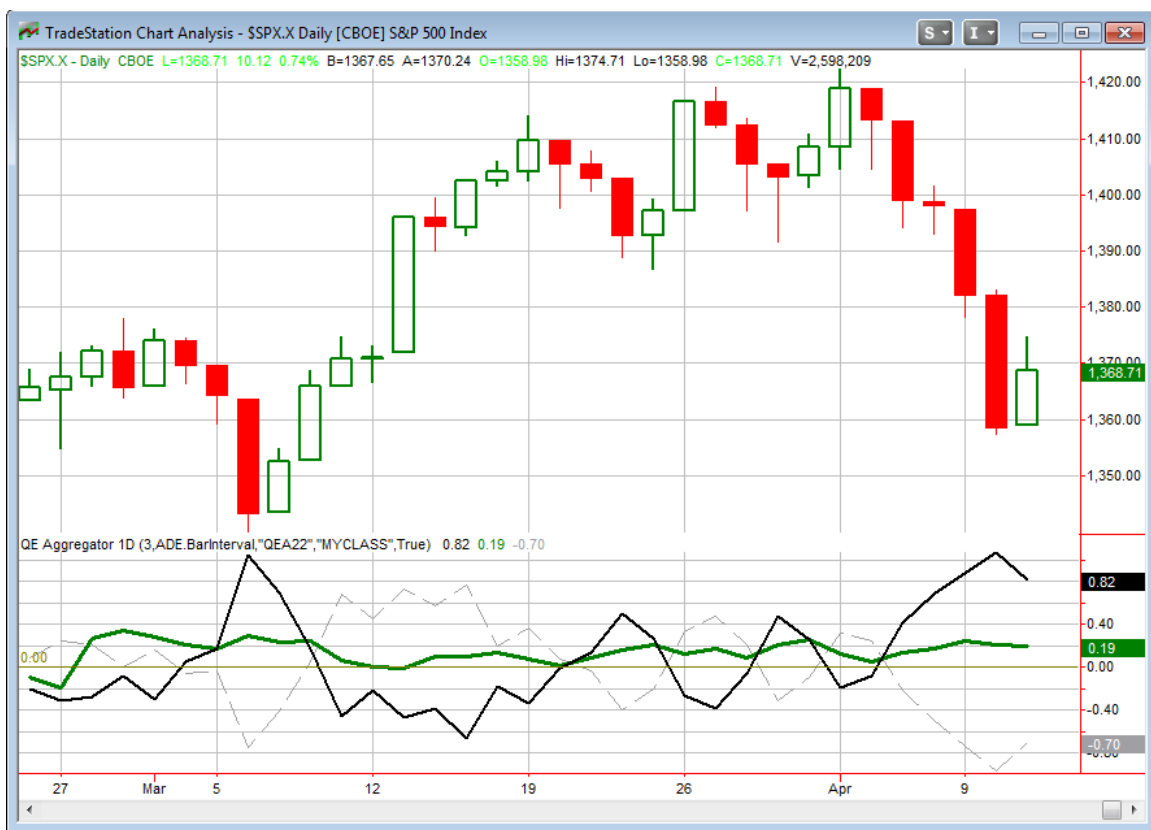
Yesterday SPX RSI(2) < 5. Today SPX closes up on higher NYSE volume. Close > 200ma.
Buy on close. Sell X days later. \$100k/trade. 1997 - present.

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
5	-2,071.07	19	9	10	47.37	1,342.26	3,532.25	-1,415.14	-2,969.64	0.95	0.85	-109.00
4	-4,197.57	20	11	9	55.00	929.63	2,587.95	-1,602.61	-2,541.13	0.58	0.71	-209.88
3	-10,722.45	20	6	14	30.00	1,234.45	3,939.79	-1,294.94	-2,517.13	0.95	0.41	-536.12
2	-8,343.62	20	8	12	40.00	705.60	2,794.56	-1,165.70	-1,962.36	0.61	0.40	-417.18
1	-6,590.57	20	8	12	40.00	347.28	761.76	-780.74	-1,774.60	0.44	0.30	-329.53

As you can see, the change in volume appears to have a dramatic impact on the results. It would seem that the low volume bounces may suggest that people need convincing and are not rushing back in. But over the next few days, their willingness to commit capital and desire not let the bounce get too far away from them helps to propel it further.

Perhaps my biggest concern right now when considering the evidence is that the QE Buying Power Index moved down to 0 on Wednesday. (This can be seen on the projected April QE Buying Power Index chart in the intermediate-term section below.) It is set to remain at zero on Thursday as well. In other words, while the market is stretched and suggesting a bounce is likely, the bounce does not have strong liquidity behind it. Over the last four years bounces that have occurred without being backed by liquidity have struggled. So I am not getting carried away with optimism.

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



Wednesday's action did not greatly change the Aggregator chart readings. The green Aggregator Line is strongly positive. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line is still far above zero. A positive Differential reading means the SPX has underperformed expectations over the last few days. So net expectations are very 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 Thursday. It would take some extremely bearish evidence to change this. Meanwhile, the Differential Pivot will be well above current prices at 1,389.46 on Thursday. This is 1.5% above Wednesday's close. That is possible, but a multi-day move may still be required to work off the oversold condition.

The CBI only moved up 1 today and is now at 7. The aggregator appears strongly bullish, but like I mentioned above the QE Buying Power Index has me wary. So I'm not looking to add more index exposure at this point. Instead I will simply hold on another day and reconsider the odds Thursday evening.

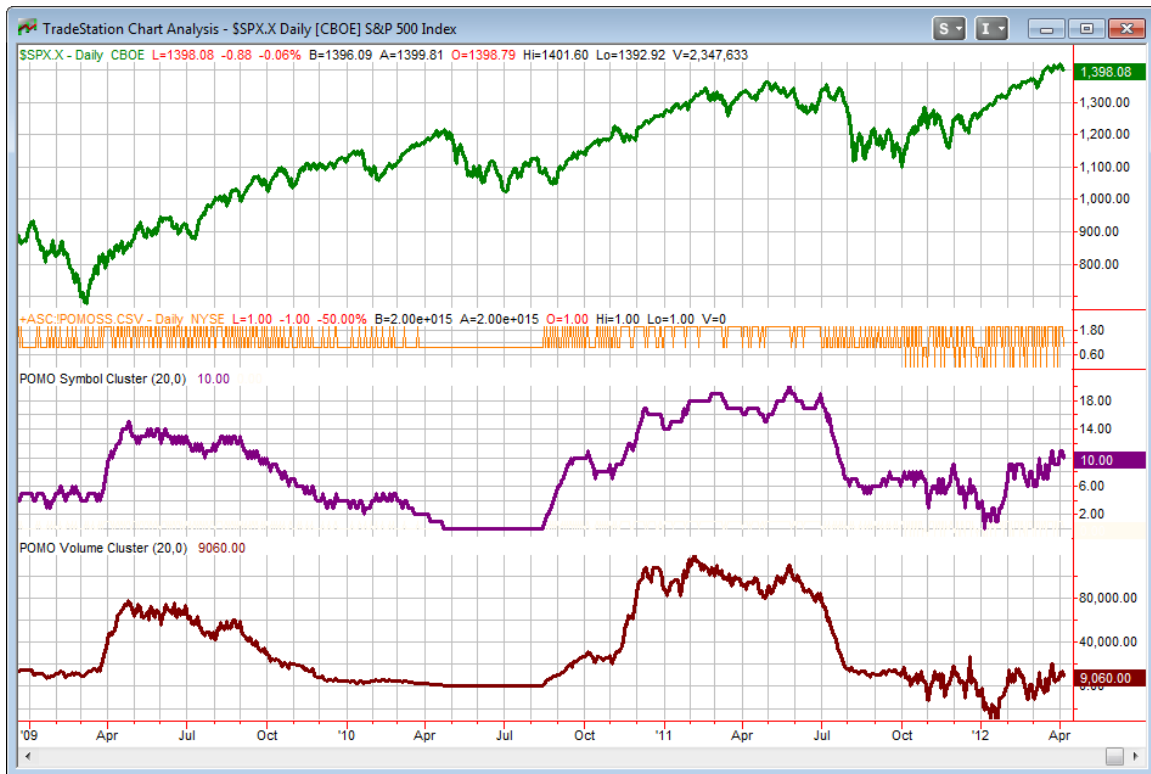
Intermediate-term Outlook (2 weeks – 2 months)– updated 4/9 – neutral

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.)

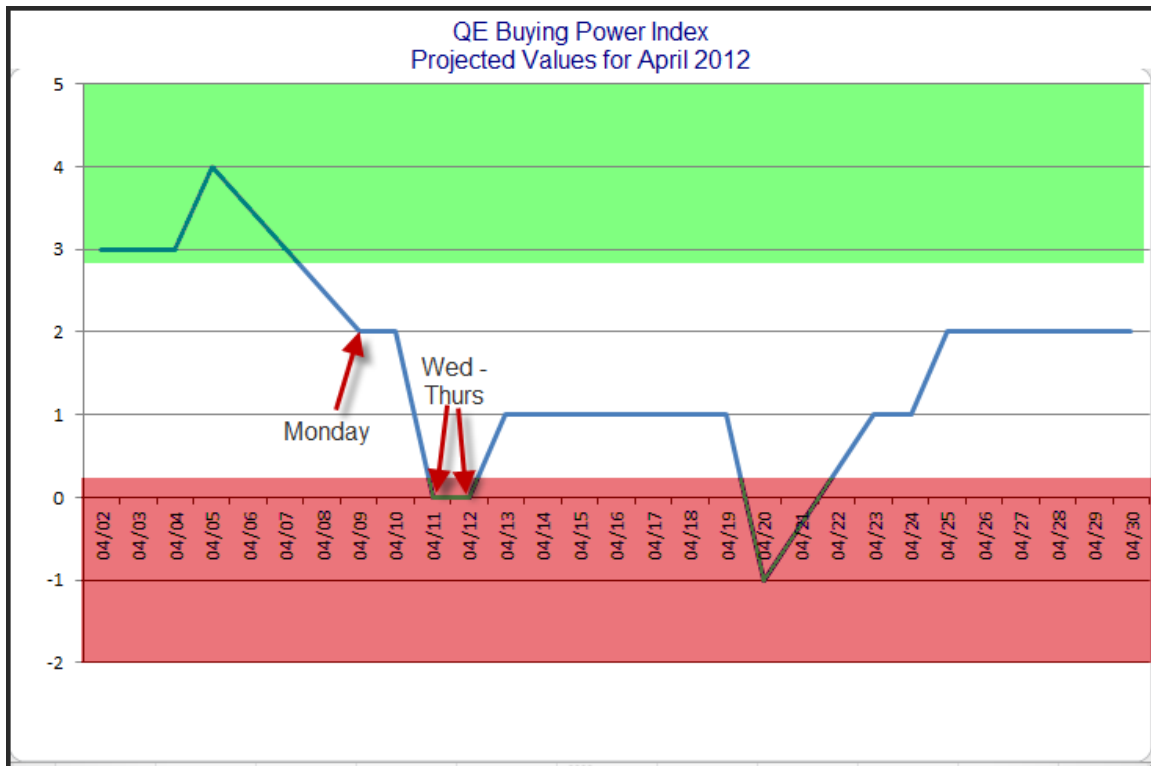
<http://www.quantifiableedges.com/members/pomo.php>



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

BAX @ \$57.67 – not filled

IBM @ \$202.37 – not filled

JPM @ \$42.96 – not filled

KO @ \$72.02 – filled @ \$72.02

QCOM @ \$66.25 – filled @ \$66.25

TGT @ \$56.40 – not filled

New

QCOM @ \$66.22 (buy 1/3 @ limit)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 7/6(BAX, IBM, JPM, KO, QCOM-2, TGT)

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.

BAX - buy 1/3 position @ \$57.67 limit

IBM – buy 1/3 position @ \$202.37 limit

JPM - buy 1/3 position @ \$42.96 limit

TGT- buy 1/3 position @ \$56.40 limit

QCOM - buy 1/3 position @ \$66.22 limit (new)

Four of the Catapult triggers from last night failed to fill. While I sometimes pull them off when that happens, I decided to leave the orders open for another day.

While Catapults have done well over the years, they have a tendency to be very volatile. For more detailed information on the Catapult strategy you may view the Catapult & CBI presentation.

[Catapult & CBI Presentation Link](#)

More information and ideas on trading Catapults can be found in the Catapult Exit Designer package available to subscribers on the Downloads page.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	4/5/2012	\$139.38	\$137.00	-1.71%		Aggregator
SPY(1/4)	4/9/2012	\$138.03	\$137.00	-0.75%		Aggregator
KO(1/3)	4/11/2012	\$72.02	\$72.12	0.14%		Catapult
QCOM(1/3)	4/11/2012	\$66.25	\$66.22	-0.05%		Catapult

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