

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 30, 2012

Volume 5 Issue 82

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Short	Short 100% SPY	Flat	Flat

Tonight's Research Points

- When the VIX and SPX have both closed up on a Friday, that has typically been followed by a pullback in SPX.
- SPY's extremely light volume on a day where it closes at a short-term high suggests a pullback is in order.
- The Nasdaq has taken back leadership from the SPX – an intermediate-term positive.
- The POMO schedule for May will be released by the Fed on Monday afternoon.

Short-term Outlook

The Bottom Line

The Aggregator is suggesting a downside edge. I have a small short position and will increase it if the SPY rises a bit more during the day Monday.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
April 30, 2012	SPY 10-high on 20-low vol.	1-4 days	Bearish	-1.40%
April 30, 2012	SPX & VIX up Friday. SPX > 200ma	1-3 days	Bearish	-1.30%
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	
December 5, 2011	POMO activity flat to negative	int term	Bearish	
Dropped Tonight				
April 26, 2012	Gap & go on a Fed Day	1-2 days	Bearish	-1.50%

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

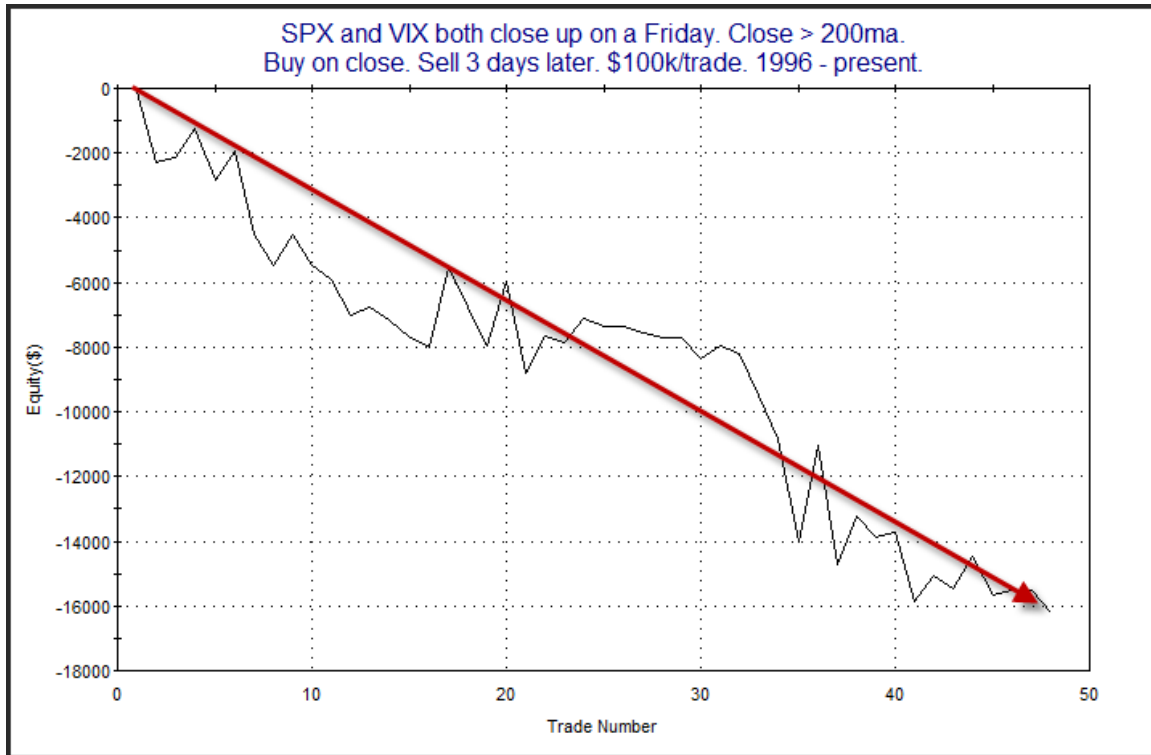
The Evidence

The market was able to put in more gains on Friday, but buying seemed more muted than the last 2 days. The SPX managed a 0.2% gain while the Nasdaq rallied 0.6% and the Russell 2000 rose 0.9%. Breadth was positive as the NYSE Up Issues % came in at 66% and the Up Volume % was 59%. Total NYSE volume ran light for most of the day and finished below the level of the last two days.

Even with the SPX rising, the VIX managed to close up a bit. The VIX will typically trade in a direction opposite the SPX, so it is unusual that they both close higher. On Fridays, the VIX has a natural tendency to dip in the afternoon, so it is *most* unusual to see them both close higher on Friday. The study below was last seen in 4/2/12 subscriber letter. It examines other instances of the VIX and SPX both closing higher on a Friday while the SPX is in an uptrending market. All stats are updated.

SPX and VIX both close up on a Friday. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1996 - 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	-12,423.10	47	19	28	40.43	1,464.44	4,290.80	-1,437.41	-3,118.36	1.02	0.69	-264.32
4	-15,935.06	48	20	28	41.67	1,088.02	4,275.84	-1,346.26	-4,306.02	0.81	0.58	-331.98
3	-16,186.25	48	17	31	35.42	973.19	3,000.26	-1,055.82	-3,727.50	0.92	0.51	-337.21
2	-12,407.56	48	20	28	41.67	783.66	2,380.51	-1,002.88	-3,595.20	0.78	0.56	-258.49
1	-9,680.34	48	16	32	33.33	501.77	1,530.15	-553.40	-2,361.45	0.91	0.45	-201.67
45 of 48 instances (94%) closed below the entry price at some point in the next week.												

As you can see, there appears to be a decent downside edge suggested by this study. That edge primarily plays out over the first three days. Below is an equity curve showing how the edge has evolved assuming that 3-day holding period.



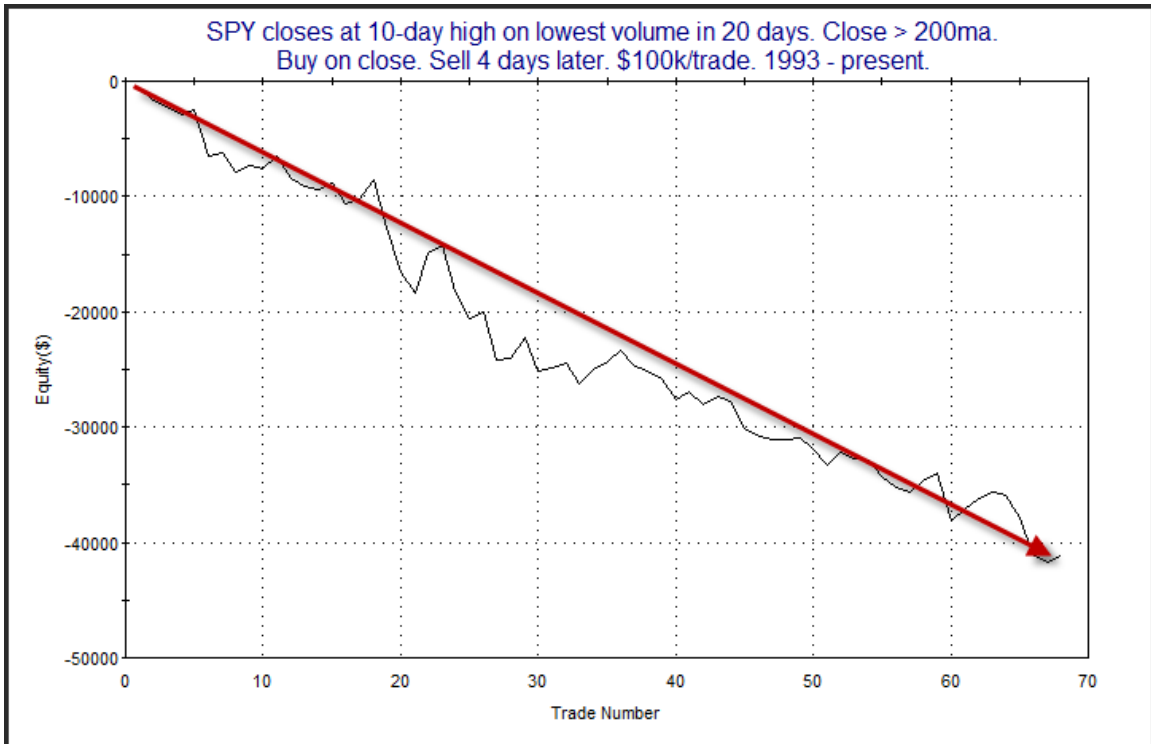
Considering the fact that the study utilizes a long-term uptrend filter, the persistent downslope is quite impressive. The last instance once again put the equity curve at new lows.

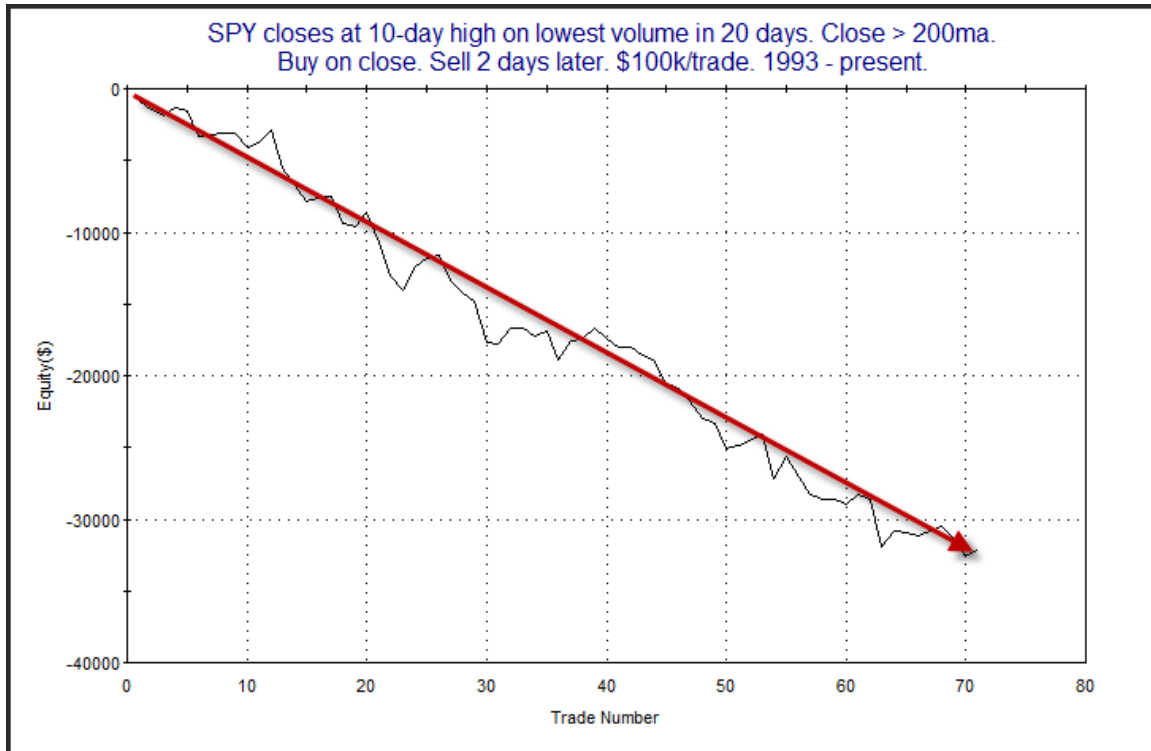
NYSE volume came in light, but SPY volume was *extremely* low. That has typically been a bad sign when SPY closes at a high level. The study below addresses this. It was last seen in the 7/25/11 subscriber letter. All stats are updated.

SPY closes at 10-day high on lowest volume in 20 days. Close > 200ma.
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
5	-26,520.06	67	31	36	46.27	964.44	3,379.48	-1,567.16	-4,272.30	0.62	0.53	-395.82
4	-41,153.71	68	28	40	41.18	802.71	3,379.48	-1,590.74	-4,141.80	0.50	0.35	-605.20
3	-33,993.83	68	27	41	39.71	702.86	4,032.73	-1,291.98	-4,581.36	0.54	0.36	-499.91
2	-32,191.07	71	26	44	36.62	562.48	1,637.48	-1,063.99	-3,265.65	0.53	0.31	-453.40
1	-13,844.68	74	26	48	35.14	471.62	1,114.56	-543.89	-1,935.36	0.87	0.47	-187.09

This study looks back to the inception of the SPY in 1993. As you'll see below the edge has been quite steady over this entire period. The edge appears to max out after 4 days, though most of it is realized in the 1st 2 days. Below are both 4 and 2-day equity curves.



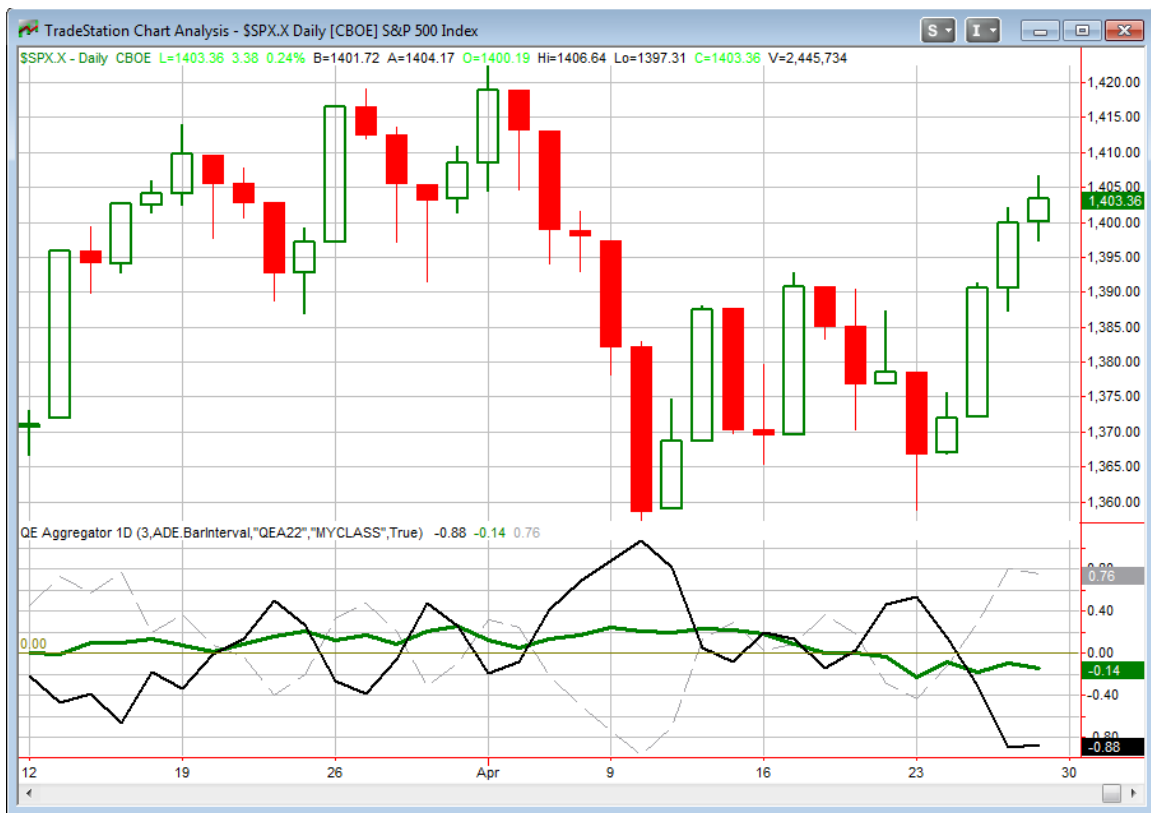


In both cases the edge appears intact. Here too the results are especially impressive considering they were all realized in long-term uptrends.

I like the combination of factors that these studies consider. Over the last few days I have noted some bearish evidence indicating we're likely to see a pullback. I kept saying the evidence was "weakly" bearish. I said that because we really only had one study supporting the bearish case. Now we have two, and they are unrelated. While they both look at price action, one considers sentiment and the other uses volume. Together they provide a fairly compelling argument.

While we don't have any short-term bullish studies on the board, there are some potentially bullish factors to consider. For one, Tuesday is the first trading day of May. As I've shown many times before, the first trading day of the month, especially in an uptrend, carries bullish tendencies. Another factor to consider is POMO activity. I will discuss it a little more in the intermediate-term section below, but the schedule for May is going to be released Monday afternoon. After that, I'll be able to forward calculate the QE Buying Power Index for May. Right now, POMO activity beyond Monday is unknown.

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



The green Aggregator line is now squarely below 0. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the rally over the last few days has placed the black Differential Line to well below zero. This suggests the SPX is short-term overbought versus expectations, and to a large degree. So net expectations are bearish and the SPX is very strongly overbought versus recent expectations. This is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close below 0. This meant the Aggregator System remained short at the close. This was indicated as likely on the systems page shortly before the bell.

Based on the current studies, expectations will remain negative on Monday. Meanwhile, the Differential Pivot will be 1,383.59 on Monday. This is 1.4% below Friday's close. It would therefore take a selloff of this magnitude on Monday to move the SPX out of overbought territory and flip the Differential Line back to positive. While possible, that may be a bit of a stretch for a one-day move. We still may need to see a multi-day pullback or consolidation in order to move off the overbought condition. I would note that the downside targets for the bearish studies tonight are for drops of 1.3% and 1.4% over the next few days. So if the market did decline 1.4% on Monday not only would the differential line flip, but both studies would come off of the Active List. This could very well mean the Aggregator signal would flip from short to long with a drop of 1.4% or more.

I'm feeling a bit more bearish today than I was the last two days. I have a small short position on already and will look to add to that position if a favorable entry avails itself on Monday. Aside from the concerns I discussed above regarding first of the month seasonality and unknown POMO activity, I also think it is worth considering where resistance levels currently are on the chart. SPY resistance is about two points above current levels where the early April highs occurred. If I could get an entry on Monday about halfway between Friday's close and the April highs, I would surely take it with another small lot.

Intermediate-term Outlook (2 weeks – 2 months)– updated 4/30 – neutral

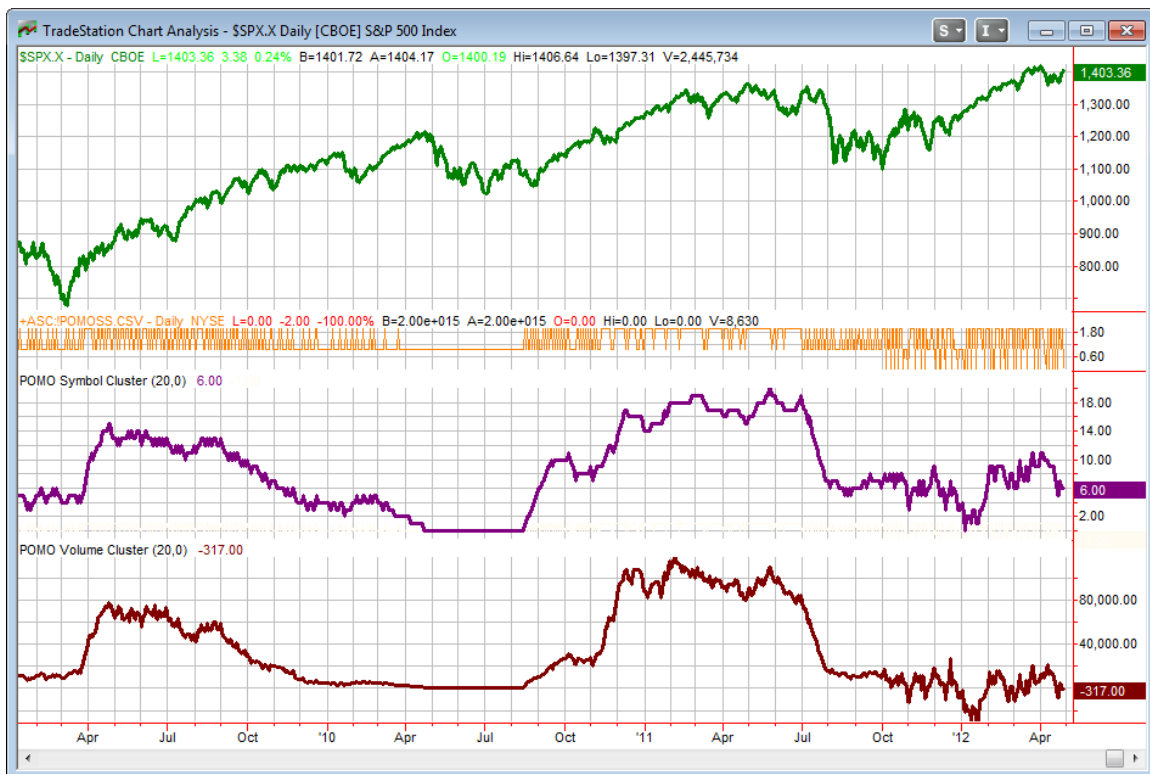
Price action was positive this week as the SPX rose 4 out of 5 days and put in solid gains for the week. The early April highs are now less than 2% away, so we are not far from seeing a resumption of the uptrend.

One bit of good news this week is that the NASDAQ was able to regain its leadership position after lagging for just one week. This is based on the SPX/NASDAQ Relative Strength Indicator that can be found on the charts page. I discussed this in some detail last week. The bottom line is that since the inception of the Nasdaq the SPX has made all of its gains and more when the Nasdaq has been in a leading position (as measured by this indicator). More information on the indicator may be found [in this old blog post](#). Any subscriber who wants to download the model may do so on [the Downloads page](#). The data in the Excel version has not been updated in a while, but the calculations are all there.

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.)

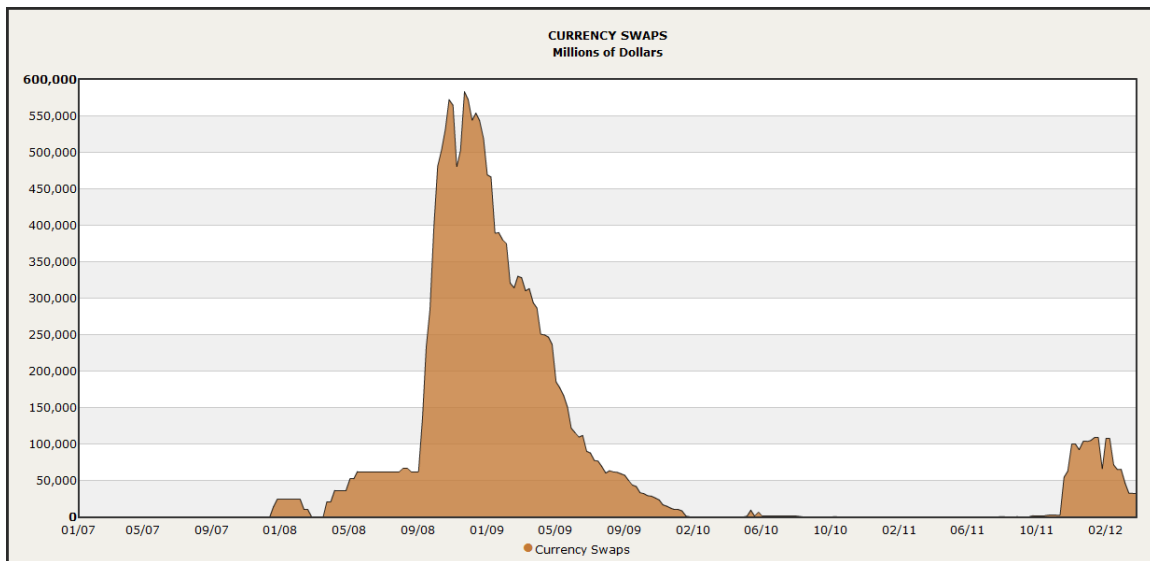
<http://www.quantifiableedges.com/members/pomo.php>



Despite 3 days of buying and only 1 day of selling this past week, the net result was a small (\$0.2 billion) outflow. The intermediate-term POMO indicators are now near the low end of their recent range. This suggests very little POMO stimulus from the Fed.

Until December the SPX chart had followed the intermediate-term POMO measurements very closely for 6 years. In December the market began a rally without strong POMO support. I noted in January that the Fed had begun to aggressively lend via currency swaps, primarily to aid Europe. This liquidity stimulus appeared to have a positive influence on the US market as well as the market rallied strongly through the end of March. This past month has been slightly negative. Below is an updated chart of open currency swaps taken from the Cleveland Fed's website.

http://www.clevelandfed.org/research/data/credit_easing/index.cfm



As you can see this stimulus has begun to be taken away, perhaps lending to the recent market struggles.

We will learn more about the timing of POMO activity when the Fed releases the May schedule on Monday afternoon, but the net stimulus is expected to be nominal with Operation Twist still in effect. Overall, from a liquidity standpoint, indications are neutral. Neutral levels of stimulus have led to market struggles over the last several years. The market has only produced strong rallies during times of strong stimulus.

Aside from the weak POMO schedule, we also need to be mindful of the weak net new highs, and possible negative impacts from rising interest rates. Intermediate-term bullish studies are still active. They consider the long-term trend, the breadth thrust in March, and now again the leading Nasdaq. I remain neutral this week. I'm not seeing compelling enough evidence to produce strong a conviction about the intermediate-term. I will continue to play both the long and the short side fairly 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.

SPY – short 1/4 index position @ \$141.25 LIMIT. Base on the short-term outlook above.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	4/26/2012	\$139.19	\$140.39	-0.86%		Aggregator

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