

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 1, 2012

Volume 5 Issue 83

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- 1<sup>st</sup> Day of the month is seasonally bullish. Especially in uptrends and especially in May.
- The unfilled gap and intraday price action suggest more selling could be on tap.
- The POMI schedule for May was released by the Fed on Monday afternoon and the QE Buying Power Index is projected.

## *Short-term Outlook*

### *The Bottom Line*

There still appears to be a mild downside edge, except for Tuesday. I am maintaining a small short position. I will cover it if the market closes down by a solid amount on Tuesday.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
March 14, 2012	1 Day of Month	1 day	Bullish	
April 30, 2012	Unfilled gap dn from 10-high. Long tail.	1-3 days	Bearish	
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%
<b>Active - Long Term</b>				
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	

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

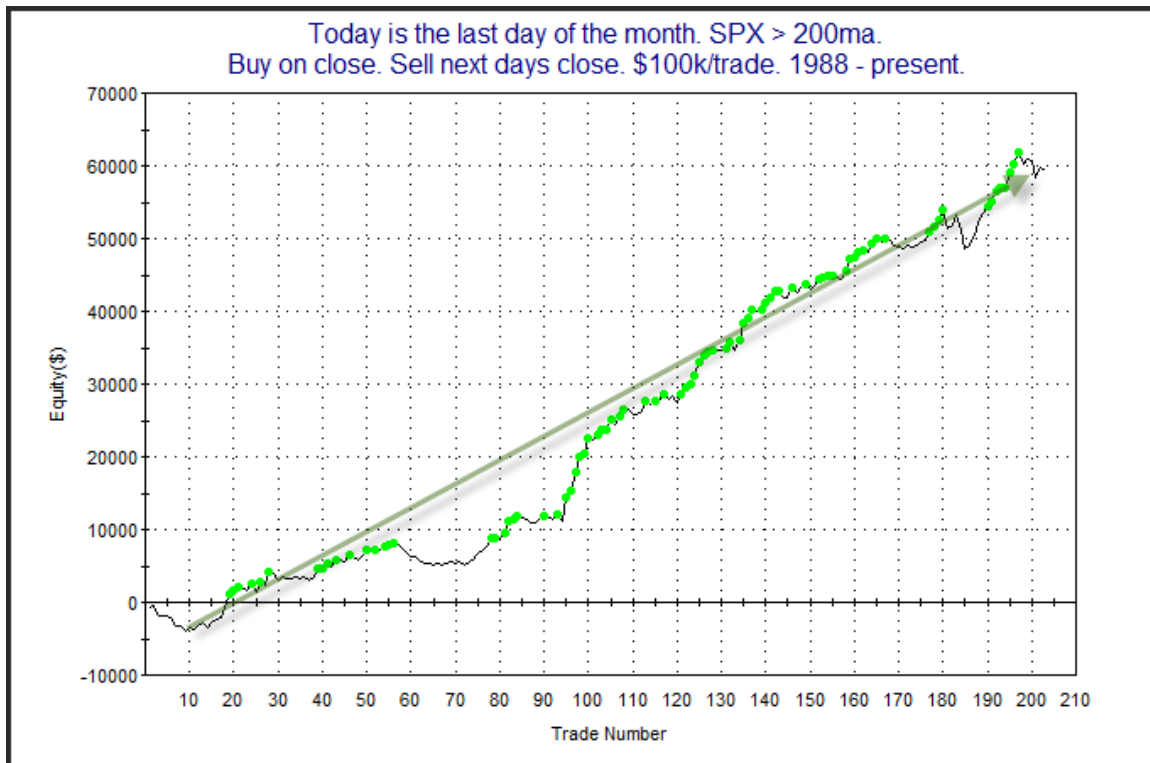
**The Evidence**

The bears were in control from the start on Monday, but the selling never became severe. The SPX lost 0.4%, the Nasdaq dropped 07% and the Russell 2000 fell 1.0%. Breadth was negative as the NYSE Up Issues % came in at 39% and the Up Volume % was 35%. Total NYSE volume rose a little from Friday's level

As I mentioned last night (and many times before), the 1<sup>st</sup> trading day of the month has long shown a bullish tendency. This has primarily been the case during uptrends. Downtrends have not shown the same tendency. The study below was last seen in the 10/3/11 Subscriber Letter. I have updated the results.

SPX closes > 200ma on last day of the month. Buy on close. Sell next day's close. \$100k/trade. 1987 - present.				
TradeStation Performance Summary				Collapse ^
All Trades				
Total Net Profit	\$61,190.13	Profit Factor		2.44
Gross Profit	\$103,763.44	Gross Loss		(\$42,573.31)
Total Number of Trades	215	Percent Profitable		61.86%
Winning Trades	133	Losing Trades		82
Even Trades	0			
Avg. Trade Net Profit	\$284.61	Ratio Avg. Win:Avg. Loss		1.50
Avg. Winning Trade	\$780.18	Avg. Losing Trade		(\$519.19)

The numbers all look very solid. Over 60% of the trades were winners, and the winners were about 1.5 times the size of the losers, making for a profit factor of nearly 2.5. Below is an equity curve that graphically displays the results of this approach.



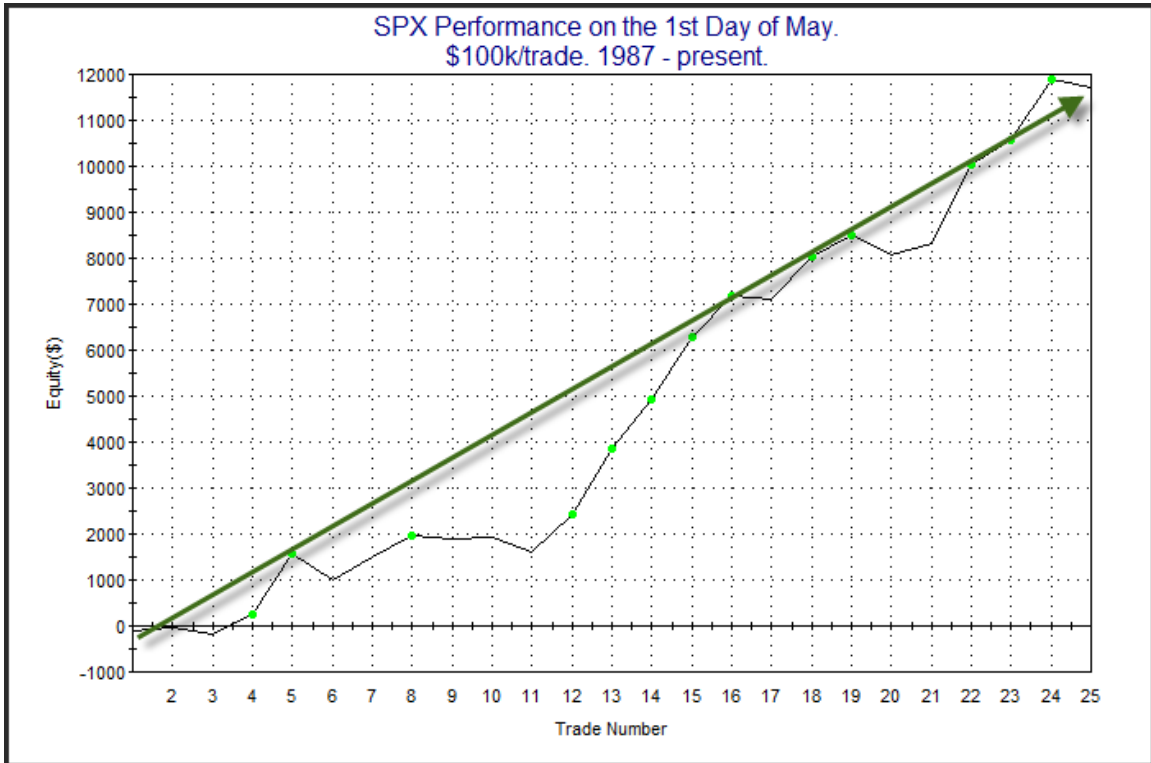
The upward slope is fairly steady and confirms the bullish tendency.

It is also worth noting that the day 1 tendency in May has been stronger than most other months. I last showed this in the 5/2/11 letter. Below are results for May dating back to 1987.

**SPX Performance on the 1st Day of May.  
\$100k/trade. 1987 - present.**

TradeStation Performance Summary		Collapse ^	
<b>All Trades</b>			
Total Net Profit	\$11,717.13	Profit Factor	7.02
Gross Profit	\$13,664.40	Gross Loss	(\$1,947.27)
Total Number of Trades	25	Percent Profitable	68.00%
Winning Trades	17	Losing Trades	8
Even Trades	0		
<u>Avg. Trade Net Profit</u>	\$468.69	Ratio Avg. Win:Avg. Loss	3.30
Avg. Winning Trade	\$803.79	Avg. Losing Trade	(\$243.41)
Largest Winning Trade	\$1,710.72	Largest Losing Trade	(\$578.40)

Stats here are strongly lopsided in favor of the bulls. Winning %, win:loss ratio, profit factor, and average trade are all outstanding. Below is the equity curve.



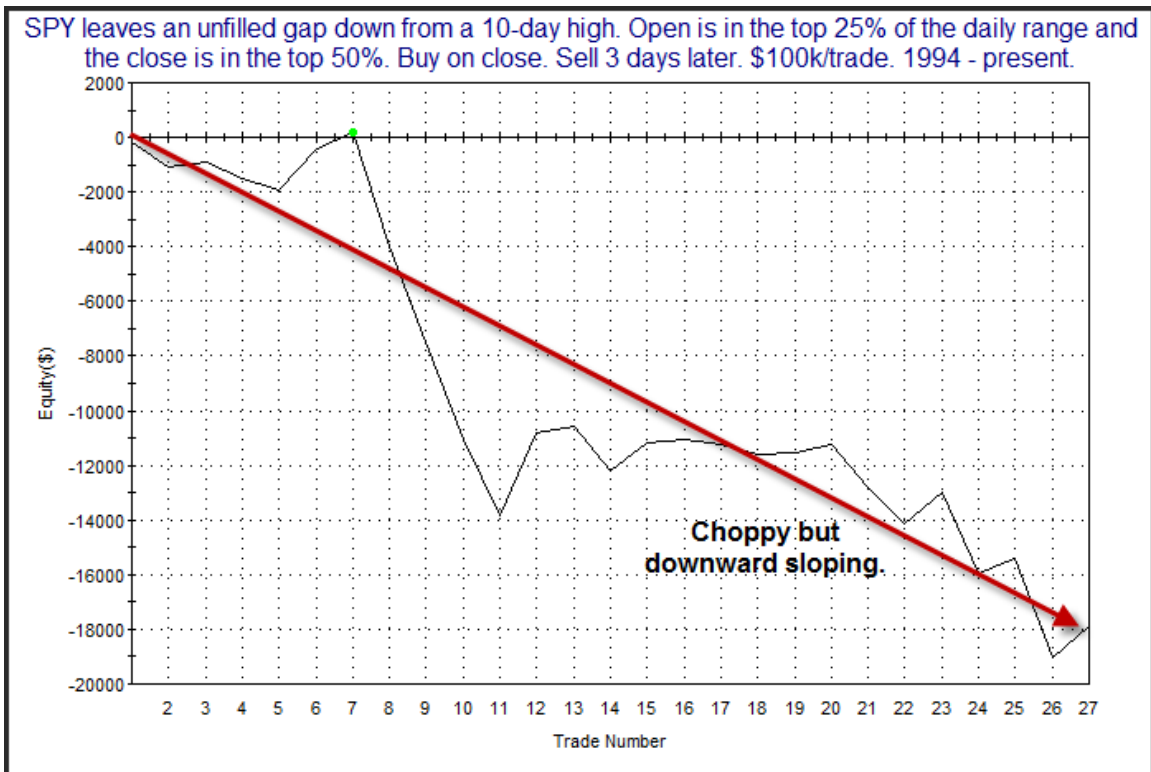
Despite last year being a small loss the equity curve appears as strong as the results table. No matter how you slice it Tuesday appears to have a solid seasonal edge.

But the unfilled gap down and intraday price action was not encouraging. In the 2/16/11 letter I looked at similar circumstances. I have updated the results below.

SPY leaves an unfilled gap down from a 10-day high. Open is in the top 25% of the daily range and the close is in the top 50%. Buy on close. Sell X days later. \$100k/trade. 1994 - 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	-18,242.42	27	11	16	40.74	892.17	2,167.34	-1,753.52	-4,604.60	0.51	0.35	-675.65
4	-15,051.70	27	11	16	40.74	1,057.32	2,838.64	-1,667.64	-4,926.08	0.63	0.44	-557.47
3	-17,885.65	27	12	15	44.44	831.02	3,040.03	-1,857.20	-4,194.90	0.45	0.36	-662.43
2	-12,766.32	27	13	14	48.15	808.63	2,953.72	-1,662.75	-4,109.04	0.49	0.45	-472.83
1	-9,395.59	27	11	16	40.74	599.94	1,440.24	-999.69	-1,948.10	0.60	0.41	-347.98

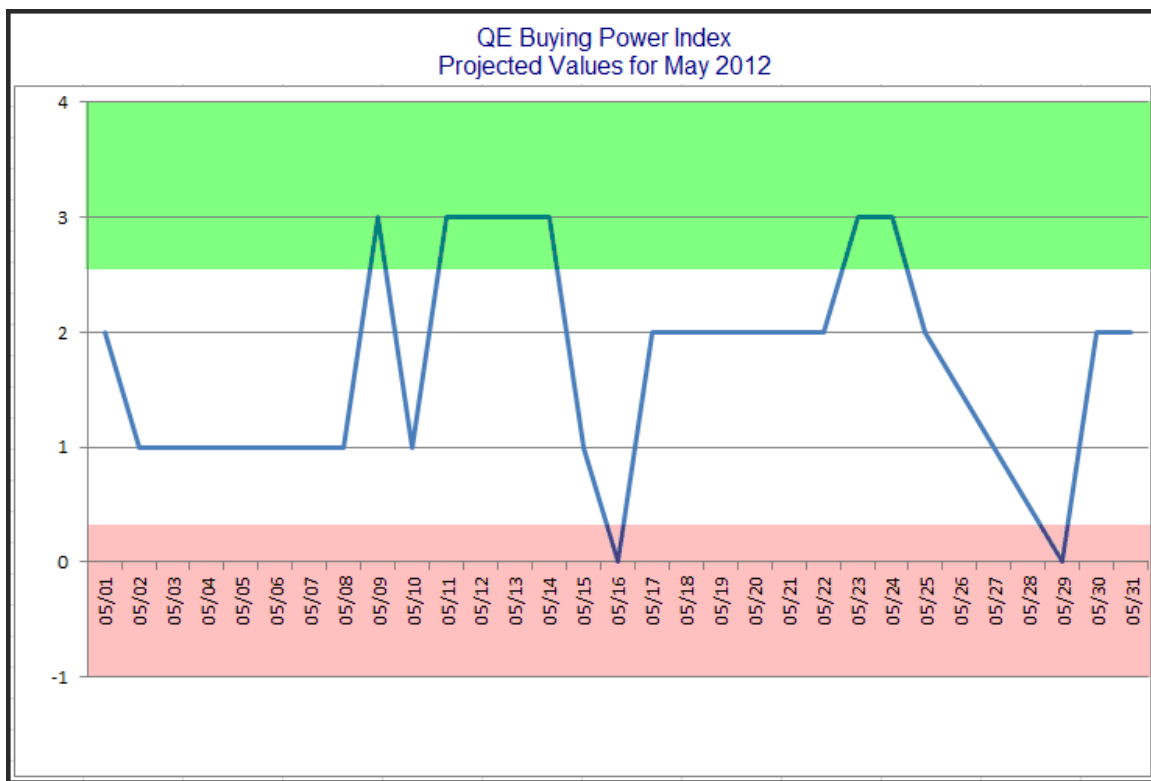
When the gap goes unfilled and the open and close are in the upper end of the day's range as described above, inclinations appear to be quite bearish. Below is an equity curve using a 3-day exit strategy.



It's not the smoothest line, but it appears good enough to me to include the study on the Active List.

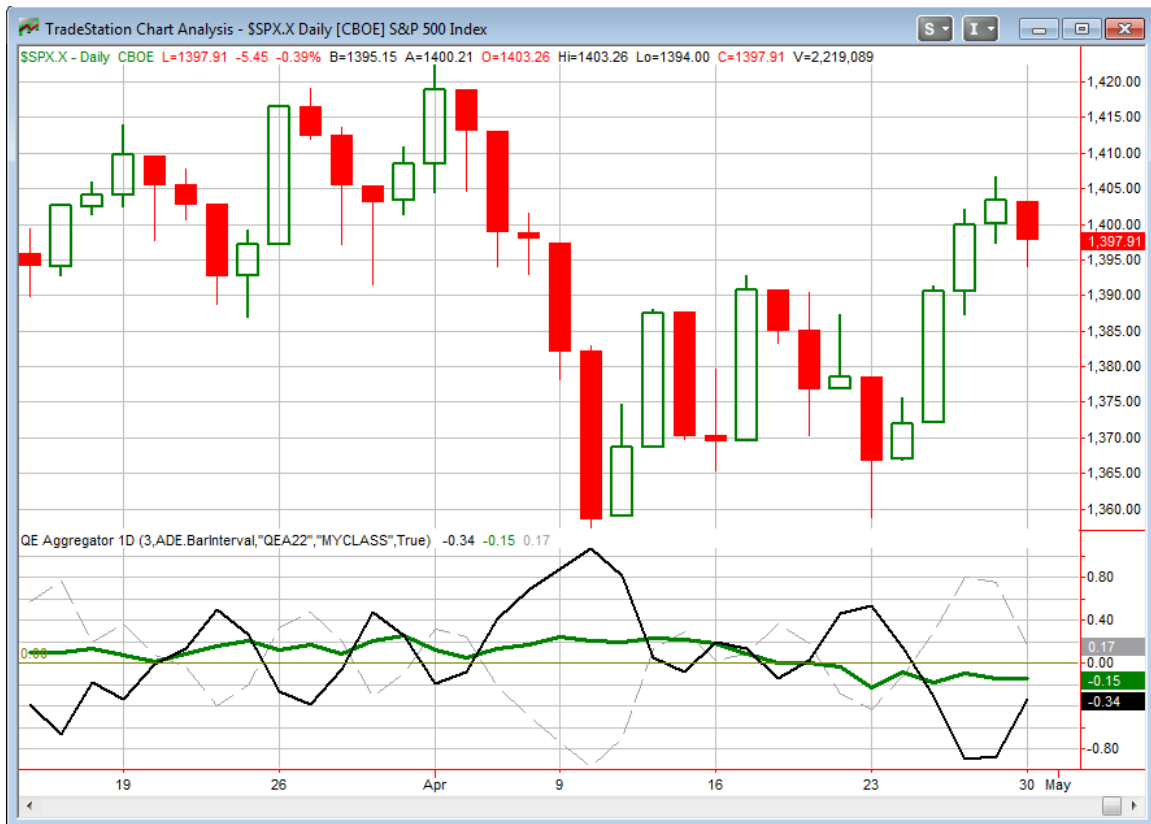
Also notable is that the Fed released its POMO schedule for May on Monday. It appears to be another month of churning as the Fed mixes buying and selling transactions. The shifting liquidity flows could provide opportunities both long and short during the month. Below I have updated the QE Buying Power Index. It is also updated on the QE Buying Power Index page for subscribers.

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



Under the right conditions we could see long opportunities in the QE Buying Power Index Swing System on the 9<sup>th</sup>, 11<sup>th</sup>, 14<sup>th</sup>, 23<sup>rd</sup>, or 24<sup>th</sup>. There are 2 days where an overbought market could signal a short opportunity. Those occur on the 16<sup>th</sup> and the 29<sup>th</sup>. I'll refer back to this chart throughout the month as we approach those dates.

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



Tonight's mix of studies left the green Aggregator line solidly negative. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the recent bounce has left the black Differential Line below zero. This suggests the SPX is short-term overbought versus expectations. So net expectations are bearish and the SPX is 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 Tuesday. Meanwhile, the Differential Pivot will be 1,394.89 on Tuesday. This is only 0.2% below Monday's close. If the SPX can manage to close down at least this much then the black Differential Line will flip back to positive. This would mean the end of the short signal.

Interesting about the current setup is the divergence between the 1 and 3-day expectations. Tomorrow is expected to close higher, but over the next 3 days the studies are suggesting more downside. This is reflected at the top of the letter. The 3-day risk/reward is negative 2 but the 1-day is at a neutral "0". I continue to hold a small ¼ size short position. The market did not provide the opportunity on Monday to add to that.

I'm still not enthused about getting aggressively short. But I may consider adding more short exposure tomorrow night if the SPX closes up on Tuesday. Of course a decent down close would lead me to cover my position, since the Differential line would be moving back above 0. Details are in the trade ideas section near the bottom of the letter.

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

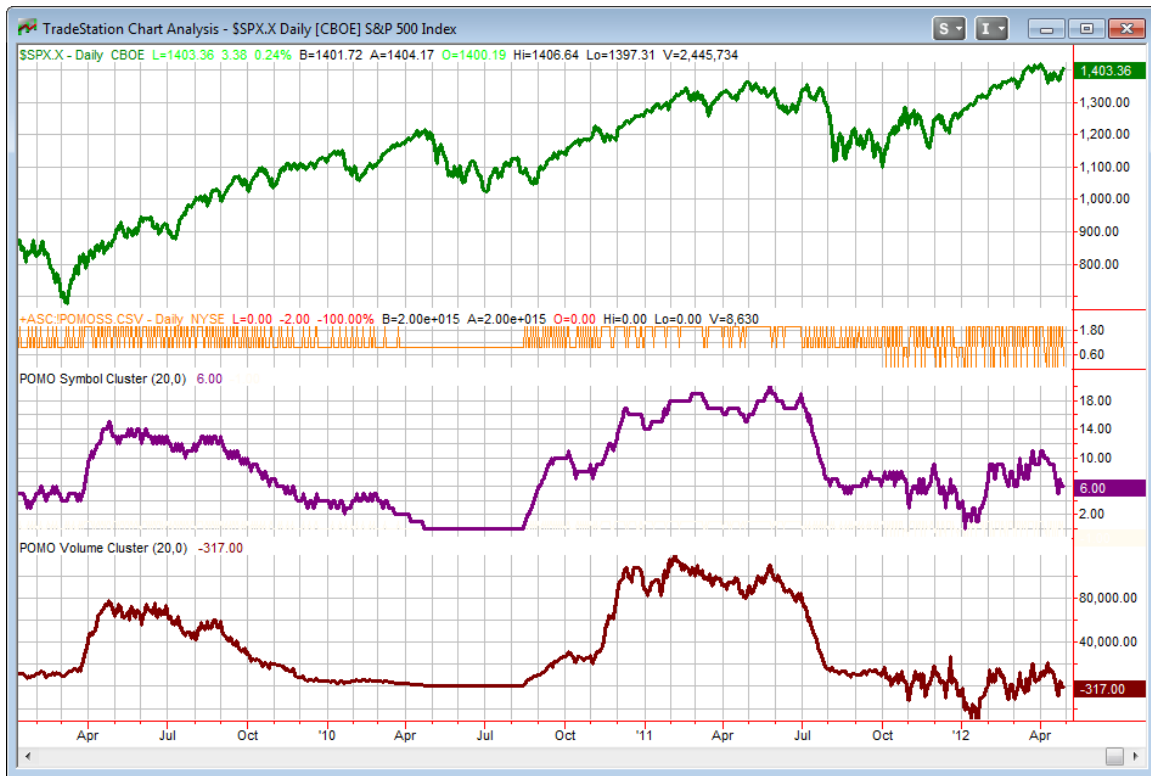
Price action was positive this week as the SPX rose 4 out of 5 days and put in solid gains for the week. The early April highs are now less than 2% away, so we are not far from seeing a resumption of the uptrend.

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 3<sup>rd</sup> POMO presentation linked below. (Not available for trial users.)*

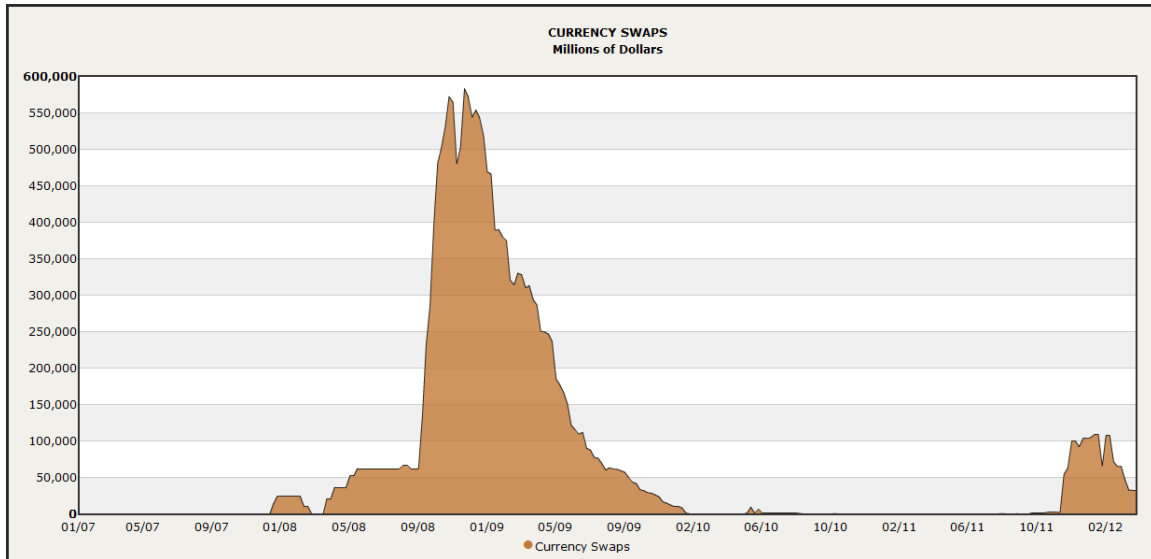
<http://www.quantifiableedges.com/members/pomo.php>



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



As you can see this stimulus has begun to be taken away, perhaps leading 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.*

*None tonight.*

## **Current Open Trade Ideas**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Price</b>	<b>% Gain/Loss</b>	<b>Stop</b>	<b>Notes</b>
SPY(1/4)	4/26/2012	\$139.19	\$139.87	-0.49%		Aggregator

*I will cover SPY on an SPX close  $\leq$  1,394.89.*

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