

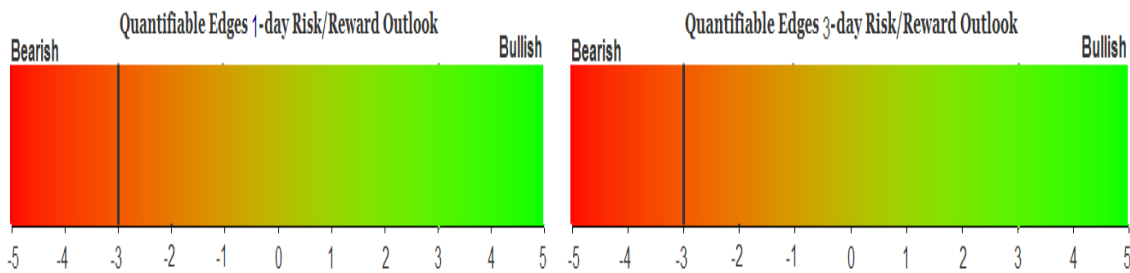
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 2, 2012

Volume 5 Issue 84

Market Overview



Signals Overview

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

Tonight's Research Points

- May 1st rallies have commonly been followed by dips.

Short-term Outlook

The Bottom Line

Evidence continues to point south. I will look to increase my short position on Wednesday if the market provides a favorable entry.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
May 2, 2012	1st Day of May was up	1-4 days	Bearish	-3.00%
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%
Active - Long Term				
April 30, 2012	Nasdaq/SPX RS favors Nasdaq	int term	Bullish	
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				
May 1, 2012	1 Day of Month	1 day	Bullish	

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

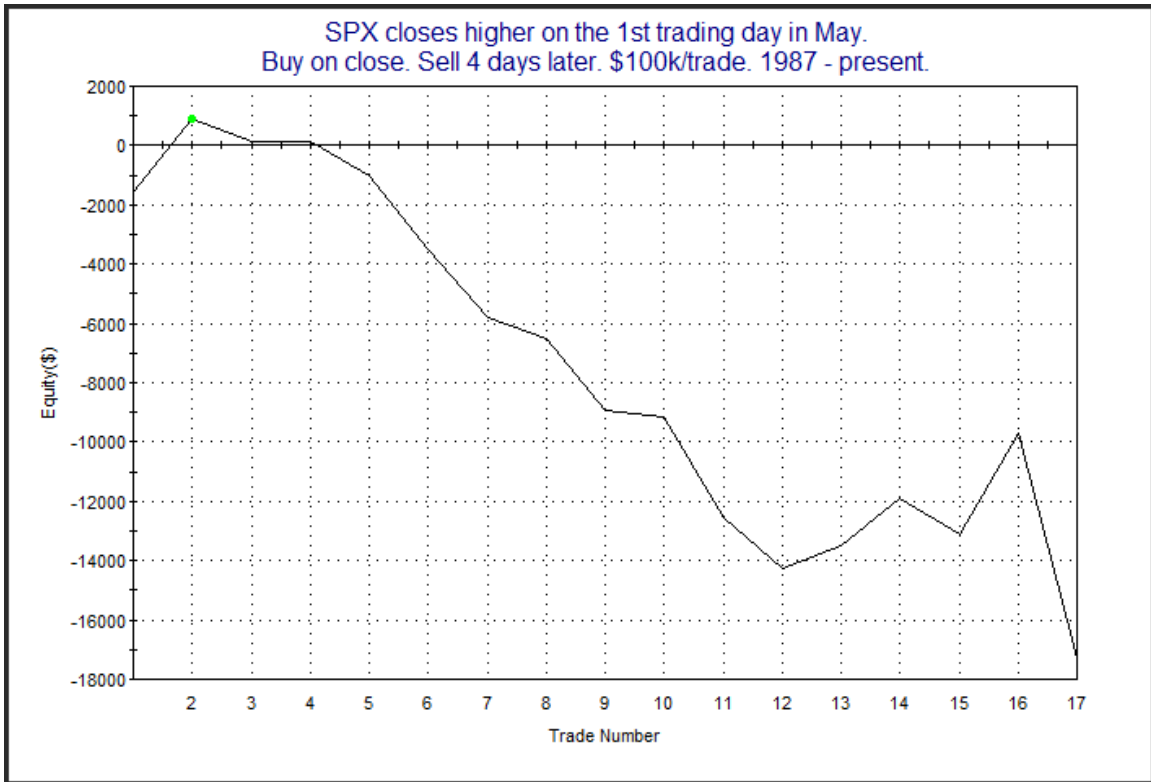
The Evidence

Aided apparently by good news related to manufacturing, seasonality helped push the market higher on Tuesday. But a late-day swoon left the market mixed. The SPX gained 0.6% and the Nasdaq rose 0.1% but the Russell 2000 fell 0.1%. Breadth was positive as the NYSE Up Issues % came in at 64% and the Up Volume % was 72%. Total NYSE volume declined some and finished between the levels of that last 2 days.

Last night I showed the strong seasonal tendency of the SPX on the 1st trading day of May. One reader wrote and asked whether the day-1 strength exhibits a tendency to follow through or to reverse. I took a quick look and was surprised at how consistent the results were. You may find them in the table below.

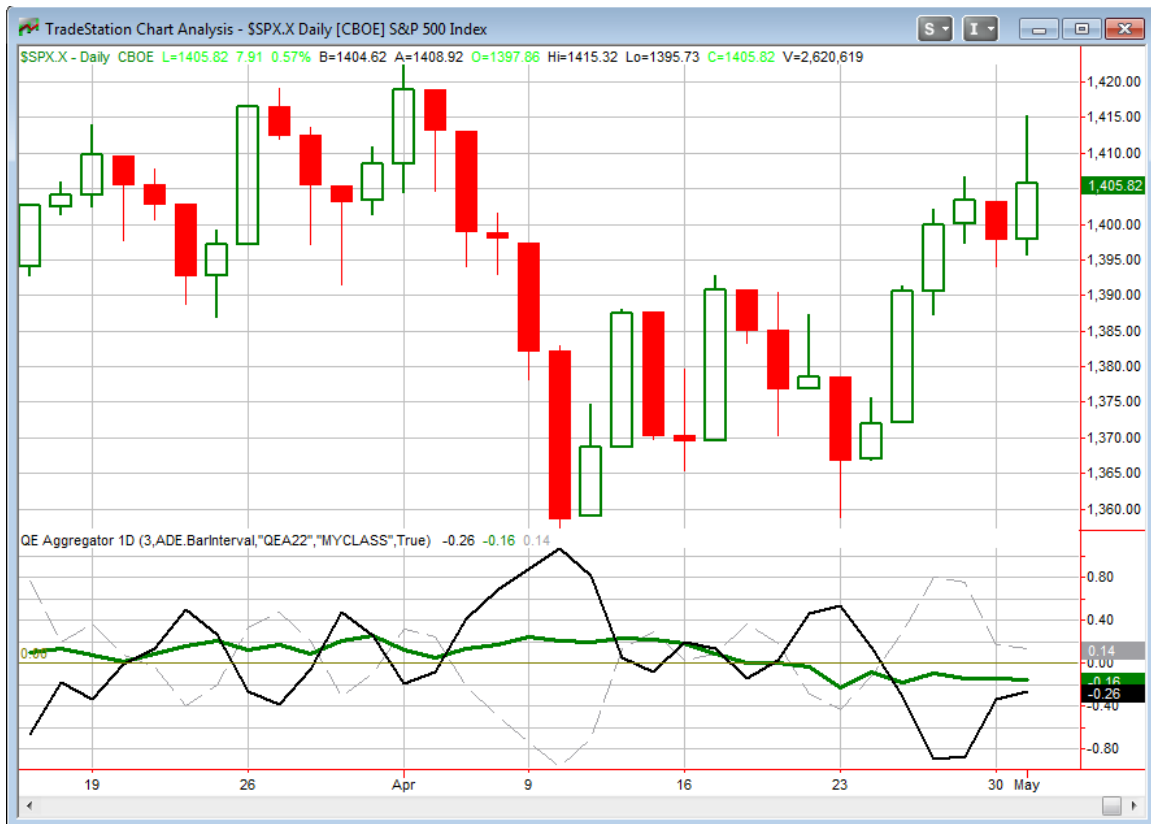
SPX closes higher on the 1st trading day in May. Buy on close. Sell X days later. \$100k/trade. 1987 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-6,951.75	17	6	11	35.29	1,989.60	5,843.23	-1,717.21	-3,529.99	1.16	0.63	-408.93
4	-17,298.75	17	4	13	23.53	2,050.46	3,375.31	-1,961.58	-7,584.54	1.05	0.32	-1,017.57
3	-10,631.05	17	7	10	41.18	1,371.02	4,747.13	-2,022.82	-6,151.13	0.68	0.47	-625.36
2	-8,038.92	17	7	10	41.18	1,022.97	2,969.64	-1,519.97	-3,614.20	0.67	0.47	-472.88
1	-1,186.80	17	11	6	64.71	572.75	3,358.36	-1,247.84	-2,378.78	0.46	0.84	-69.81

Of the 17 instances that rose on the first day in May since 1987, 13 of them closed lower 4 days later. Below is an equity curve that shows how it has played out over time.



The big drop at the end there was the 2010 Flash Crash. Even without that instance there appears to be at least a moderate downside inclination.

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



With tonight's seasonal study factored in the green Aggregator line remains 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 Wednesday. Meanwhile, the Differential Pivot will be 1,397.37 on Wednesday. This is about 0.6% below Tuesday'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.

It is notable that the SPX came very close to its April highs on Tuesday before selling kicked in during the afternoon. I have been quite cautious with approaching this Aggregator short signal up until now. But we now have 4 unique short-term studies all suggesting a dip is likely and 0 favoring the bulls. We also have defined resistance not too far above. Therefore, if we get some buying again Wednesday I will take the

opportunity to add to my small short position. Details are in the Trade Ideas section near the bottom of the letter.

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

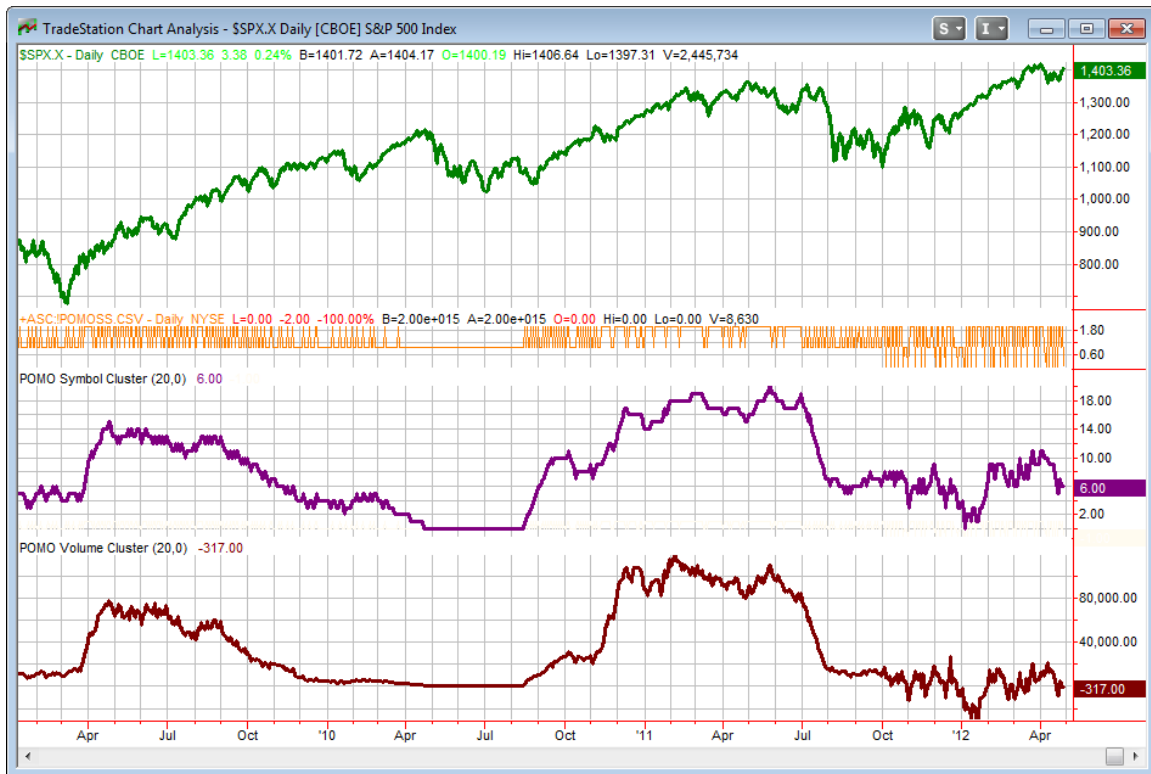
Price action was positive this week as the SPX rose 4 out of 5 days and put in solid gains for the week. The early April highs are now less than 2% away, so we are not far from seeing a resumption of the uptrend.

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 3rd POMO presentation linked below. (Not available for trial users.)

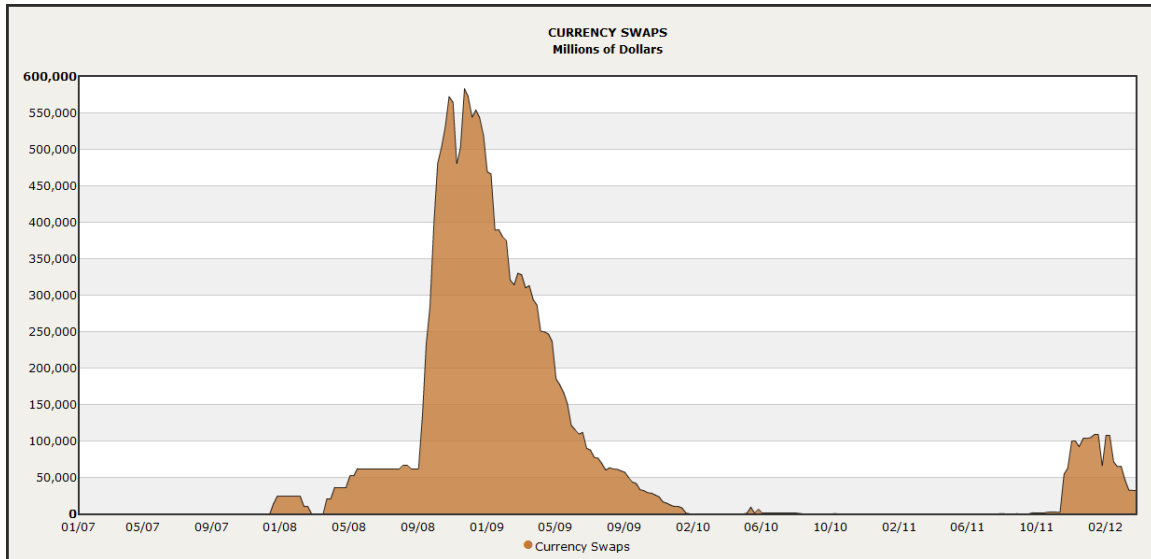
<http://www.quantifiableedges.com/members/pomo.php>



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 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.

SPY – short 1/4 index position @ \$141.25 LIMIT. This is a bit below the Tuesday high. If we again reach this level I will take that opportunity to short with the backing of the Aggregator, and short-term studies related to seasonality, sentiment, price action, and volume.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	4/26/2012	\$139.19	\$140.74	-1.11%		Aggregator

I will cover all SPY lots on an SPX close \leq 1,397.37.

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