QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 4, 2012 Volume 5 Issue 86

Market Overview

Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Flat	Long 50% XIV	Flat	Long

Tonight's Research Points

- Employment Days above the 200ma used to be bullish. Now just blah.

Short-term Outlook

The Bottom Line

Evidence is not terribly compelling and the market has performed close to expectations over the last few days. I don't see a substantial edge and have moved to flat. I expect better opportunities will avail themselves in the coming days.

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%
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	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%

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

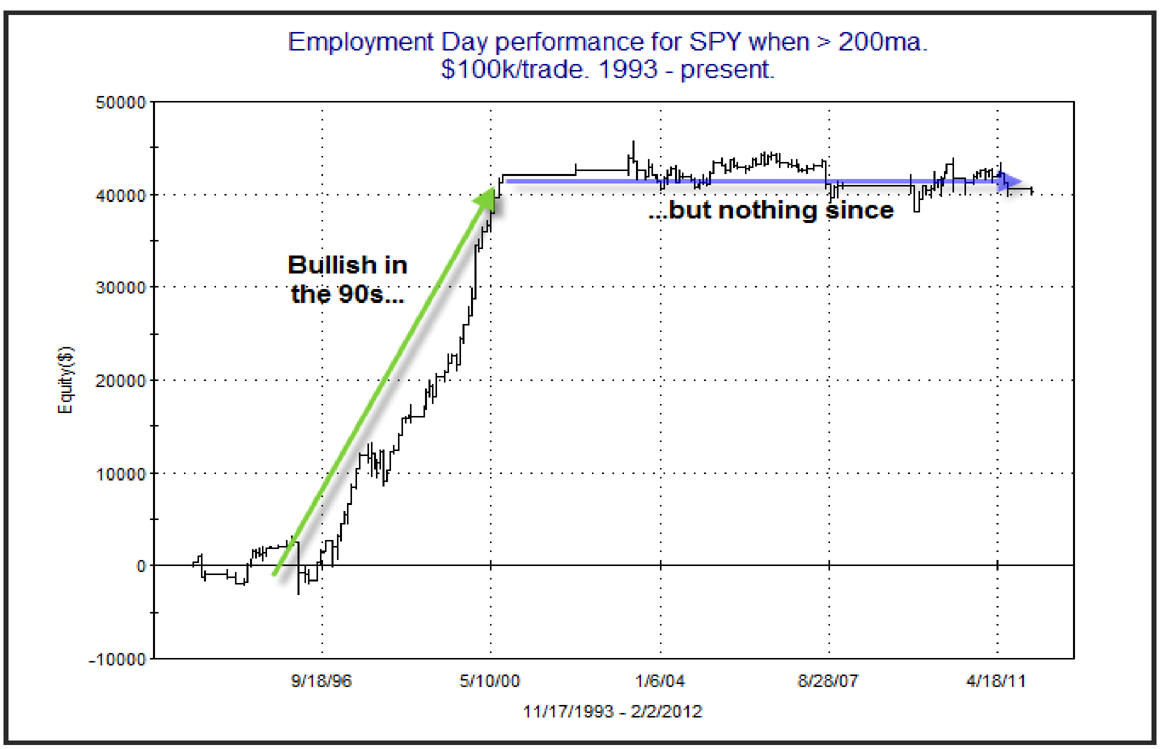
Hanna Capital Management, LLC 16 Hillcrest Rd., Medfield, Massachusetts 02052 781-956-6952

The Evidence

The market suffered some selling today. It started shortly after the open and lasted most of the day. All the major indices were losers. The SPX fell 0.8%, the NASDAQ declined 1.2%, and the Russell 2000 dropped 1.5%. Breadth was weak as the NYSE Up Issues % came in at 30% and the Up Volume % was 21%. Total NYSE volume rose above the levels of the last few days.

The market hasn't really gotten anywhere in the last several days and the choppy action has led to a dearth of tradable edges. I failed to find anything tonight suggesting a compelling edge. It is notable that Friday is an Employment Day. The excerpt below is copied (not updated) from the 2/3/12 letter a few months ago. It discusses Employment Day trading activity.

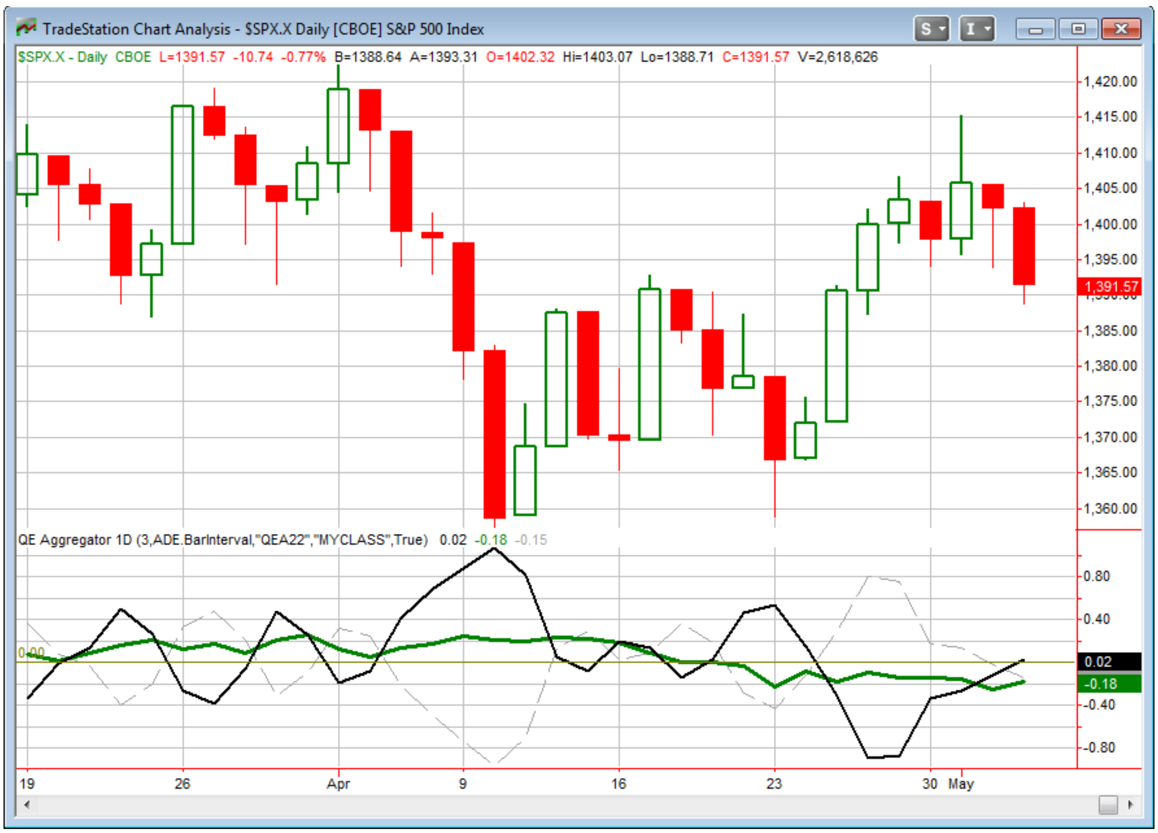
Employment days have an interesting history and they have contributed to some worthwhile studies over the years. Subscribers that would like to study Employment Days can find functions for them in the QE Indicators & Functions for Tradestation code available in the members section. Below is a chart of SPY performance on Employment Days. For this equity curve I filtered to only include days where SPY was > its 200ma. Each trade was a fictional $100k.



What I find so interesting about the chart is that for a long time Employment Days in uptrends showed a strong propensity for gains. But in 2000 this edge vanished. Since then there has been no apparent advantage – bullish or bearish. While it unusual to see such an abrupt change in market dynamics, it does provide a lesson for us. Before jumping to conclusions about edges based on statistical tables, it is important to also consider equity curves such as this one.

In looking at the Active Studies list it is important to note that with 2 studies expiring tonight, the short-term list only has 1 left. It's quite unusual only to have 1 active study. In this case it is a bearish seasonality study and it is in effect through Monday

I have updated the Aggregator chart below.



The lone bearish study is keeping the green Aggregator line negative. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line rose today and barely crossed above zero. This suggests the SPX is short-term oversold versus expectations. So net expectations are moderately bearish and the SPX is very mildly oversold versus recent expectations. It doesn't get much more neutral than this. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. This meant the Aggregator System changed from short to flat 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 Friday. Of course with only 1 study on the short-term list, this could easily change if bullish evidence emerges. Meanwhile, the Differential Pivot will be 1,399.58 on Friday. This is about 0.6% above Thursday's close. The SPX would need to rally at least this much in order to move the Differential Line back below 0, indicating a short-term overbought condition.

So there is no strong edge at the moment and the SPX has performed almost in line with expectations over the last few days. The outlook really couldn't get much more neutral. But if you look towards tomorrow a long setup could very well occur if the SPX suffers another down day. That would make 3 in a row. In an uptrend that will often lead to bullish studies. A down close would also keep the SPX oversold, all of which would likely trigger a long signal. I am not going to list a buy order in the Trade Ideas section, since the bearish expectations could possibly persist if there is not enough bullish evidence. I will instead wait until at least Monday for my next entry. But those looking to get a jump could check the Quantifinder and/or Systems pages in the afternoon and enter based on the evidence that is presented towards the end of the day.

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

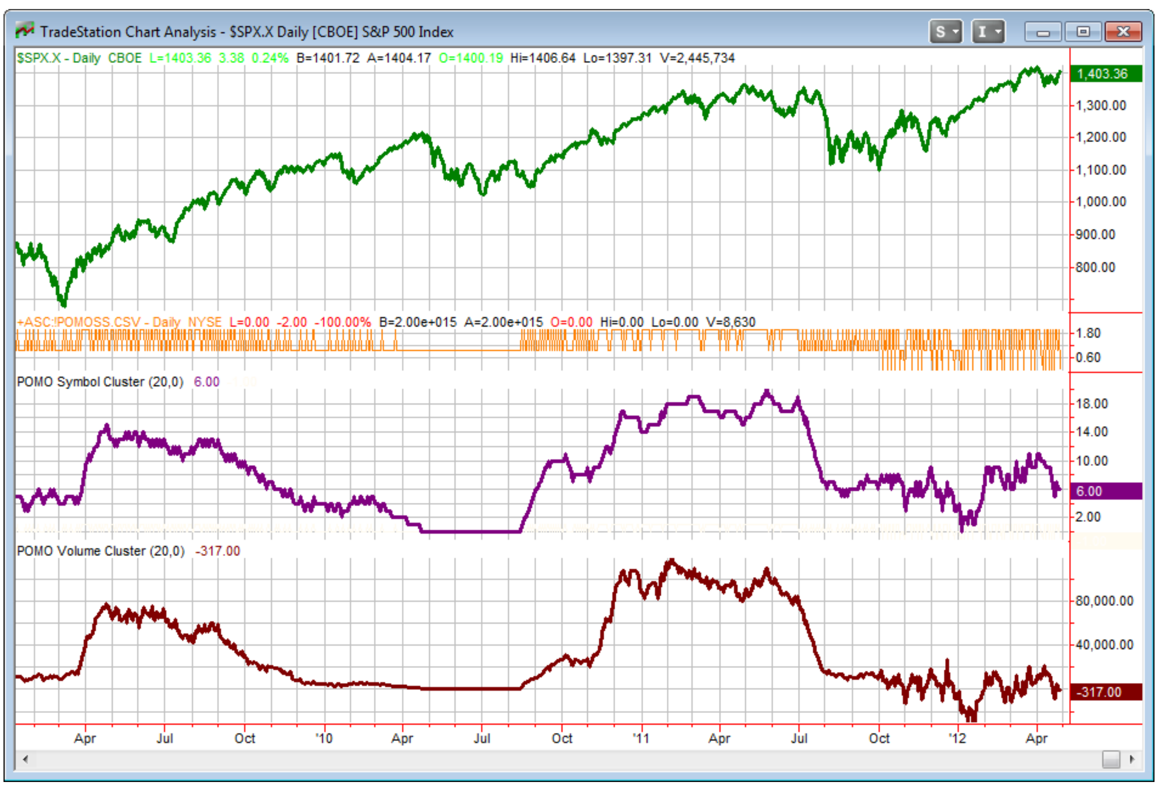
Price action was positive this week as the SPX rose 4 out of 5 days and put in solid gains for the week. The early April highs are now less than 2% away, so we are not far from seeing a resumption of the uptrend.

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.)

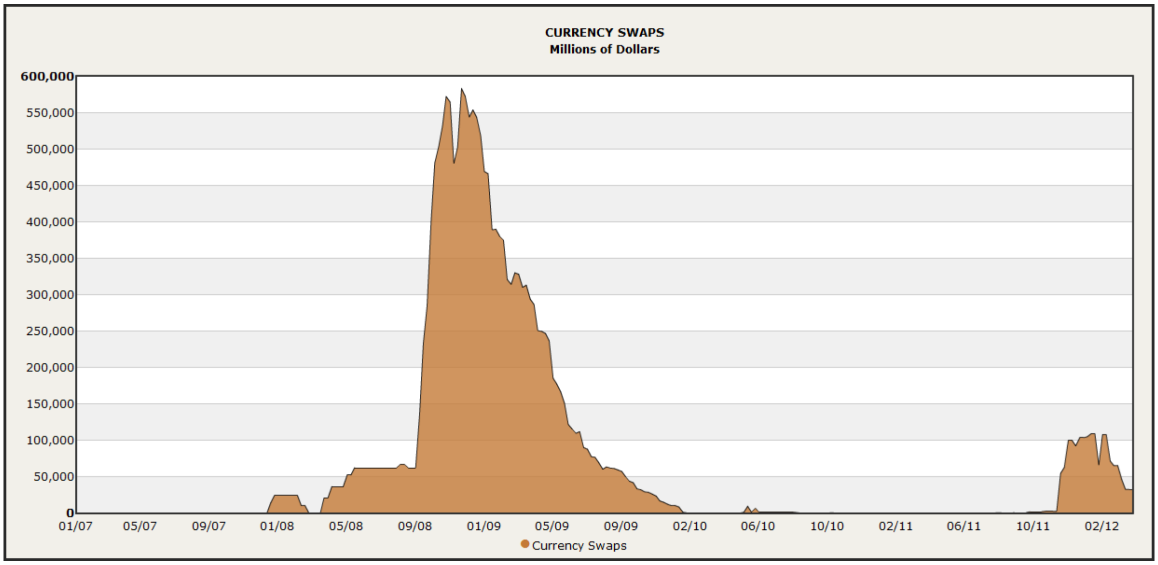
http://www.quantifiableedges.com/members/pomo.php



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.

Hanna Capital Management, LLC 16 Hillcrest Rd., Medfield, Massachusetts 02052 781-956-6952

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

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	*4/26/2012*	*$139.19*	*$139.29*	*-0.07%*		*covered on close*

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