

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 7, 2012

Volume 5 Issue 87

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- Negative employment days during uptrends are often followed by bounces on Monday.
- 3 days lower, today being the biggest drop for the SPX, has suggested an upside edge over the next few days.
- 5+ lower lows in QQQ with today being the largest decline has been followed by strong gains both short and long term.

## Short-term Outlook

### The Bottom Line

After 3 days of selling, and Friday being especially negative, the market appears to be near a bounce. I will look to begin scaling in to a long position to try and take advantage of the upside edge.

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

<b>Study Date</b>	<b>Description</b>	<b>Time span</b>	<b>Bias</b>	<b>Avg Max Move</b>
<b>Active</b>				
May 7, 2012	3 dn. Today biggest. No 20-high before	1-3 days	Bullish	1.70%
May 7, 2012	SPX Down on Employment Day > 200	1 day	Bullish	
May 2, 2012	1st Day of May was up	1-4 days	Bearish	-3.00%
<b>Active - Long Term</b>				
May 7, 2012	QQQ 5 lower lows. Today biggest drop.	1-20 days	Bullish	12.30%
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	
<b>Dropped Tonight</b>				
April 30, 2012	Nasdaq/SPX RS favors Nasdaq	int term	Bullish	

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

**The Evidence**

Friday was owned by the bears from start to finish. The SPX fell 1.6%, the NASDAQ declined 2.3%, and the Russell 2000 dropped 1.8%. Breadth was strongly negative as the NYSE Up Issues % came in at 25% and the Up Volume % was 14%. Total NYSE volume finished down just slightly on the day.

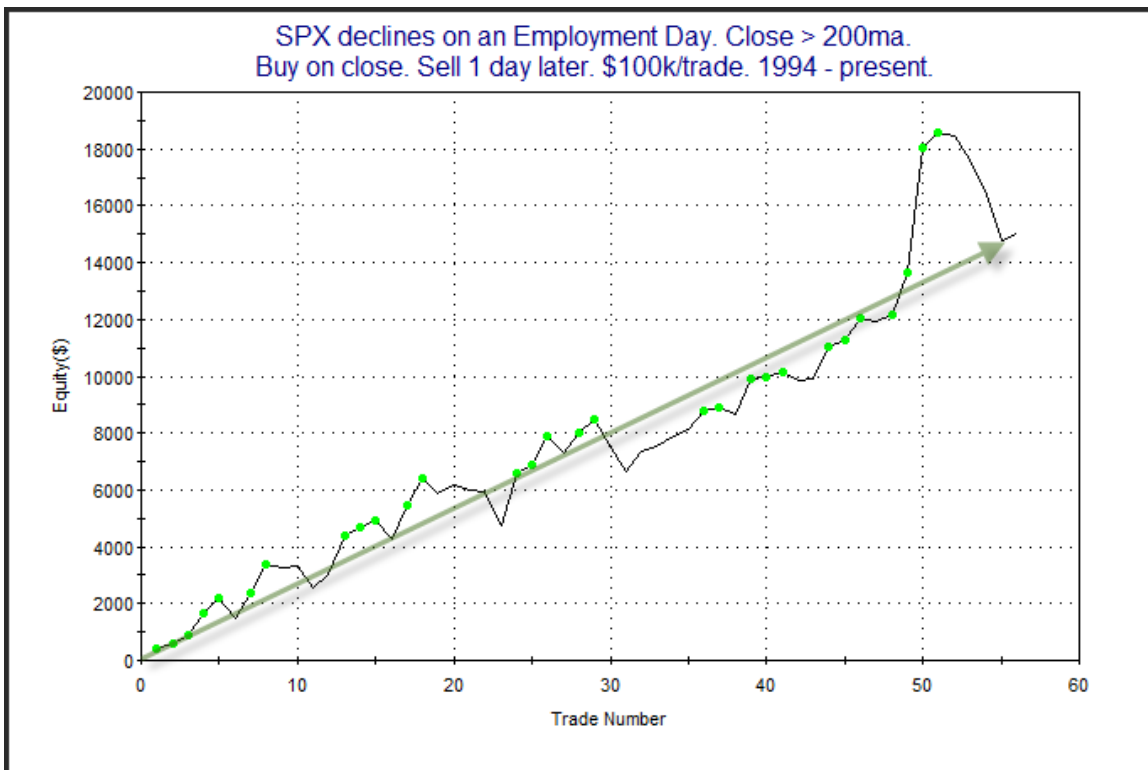
The strong selling triggered a number of studies suggesting the market is becoming primed for a bounce. Some of the more compelling ones are covered below.

One study worth mentioning examined SPX performance after weak Employment Days (during uptrends). It showed that such days were often followed by a bounce the next day. It last appeared in the 1/9/12 letter and I have updated the stats below.

SPX declines on an Employment Day. Close > 200ma.  
Buy on close. Sell 1 day later. \$100k/trade. 1994 - present.

TradeStation Performance Summary <span style="float: right;">Collapse ^</span>			
All Trades			
Total Net Profit	\$14,999.10	Profit Factor	2.34
Gross Profit	\$26,221.87	Gross Loss	(\$11,222.77)
Total Number of Trades	56	Percent Profitable	67.86%
Winning Trades	38	Losing Trades	18
Even Trades	0		
Avg. Trade Net Profit	\$267.84	Ratio Avg. Win:Avg. Loss	1.11
Avg. Winning Trade	\$690.05	Avg. Losing Trade	(\$623.49)
Largest Winning Trade	\$4,396.50	Largest Losing Trade	(\$1,798.94)

The stats here are quite strong and all point to an upside edge. I produced a profit curve below to see how the possible edge has played out over time.



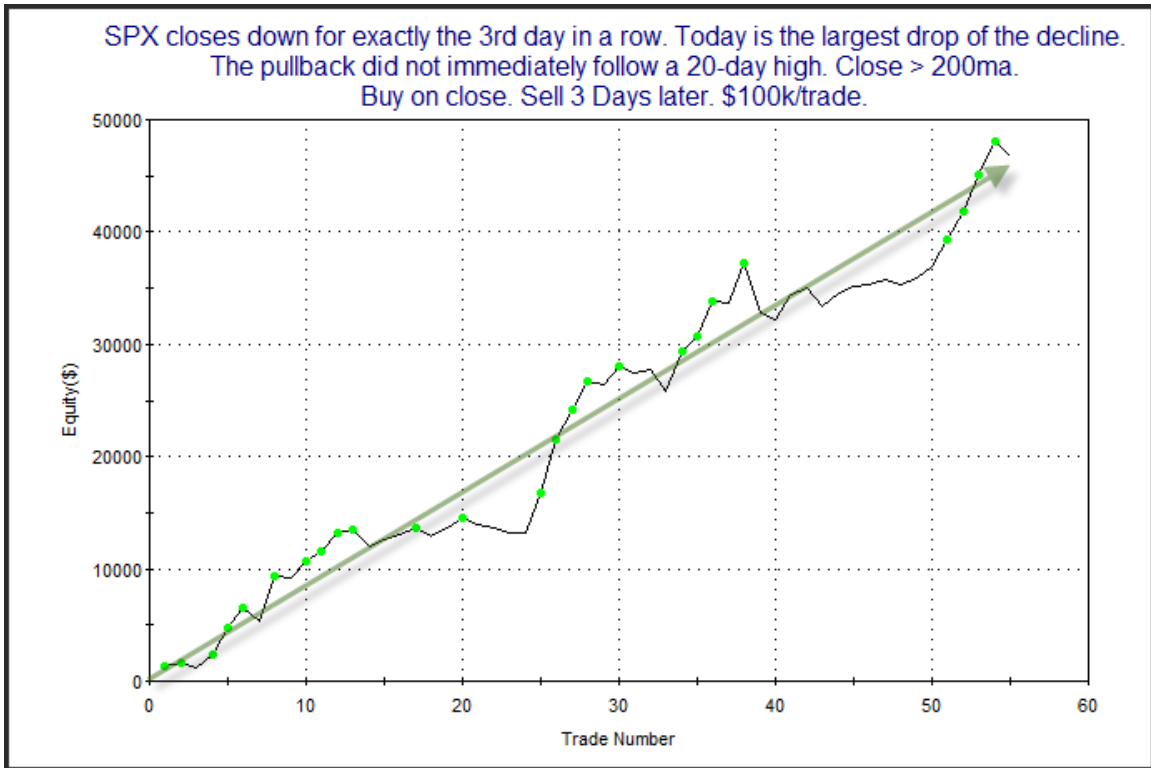
There were 4 instances in 2011 and they all closed lower. The January 2012 instance showed a more typical gain. With a sample size this large the rough 2011 doesn't mean the edge has run its course. In fact, the profit curve is now back to its long-term

trendline. Of course it will be important to monitor going forward, but I still think a bullish edge exists.

The fact that Friday was the 3<sup>rd</sup> down day in a row was also notable. I've discussed 3-day pullbacks many times before and several studies associated with them came up tonight. They tend to provide a nice upside edge under the right conditions. The study below considers the fact that today's drop was especially large compared to the previous 2 days. It last appeared in the 7/28/11 letter. All information has been updated.

SPX closes down for exactly the 3rd day in a row. Today is the largest drop of the decline. The pullback did not immediately follow a 20-day high. Close > 200ma. Buy on close. Sell X Days later. \$100k/trade.												
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	49,219.66	51	36	15	70.59	2,718.16	7,724.60	-3,242.26	-13,993.88	0.84	2.01	965.09
9	63,401.76	51	39	12	76.47	2,531.61	7,138.30	-2,944.26	-10,059.36	0.86	2.79	1,243.17
8	56,672.79	52	40	12	76.92	2,378.86	6,612.06	-3,206.79	-14,092.68	0.74	2.47	1,089.86
7	46,186.51	52	37	15	71.15	2,204.37	8,110.70	-2,358.34	-8,018.76	0.93	2.31	888.20
6	38,069.64	53	38	15	71.70	2,090.74	8,427.90	-2,758.57	-11,373.96	0.76	1.92	718.30
5	53,123.02	54	35	19	64.81	2,119.76	6,188.00	-1,108.87	-4,961.56	1.91	3.52	983.76
4	42,278.40	55	38	17	69.09	1,700.36	4,731.13	-1,313.84	-3,863.84	1.29	2.89	768.70
3	46,738.14	55	38	17	69.09	1,669.30	4,676.10	-982.08	-4,464.88	1.70	3.80	849.78
2	33,313.30	55	37	18	67.27	1,366.21	3,744.45	-957.57	-7,559.56	1.43	2.93	605.70
1	16,288.81	55	37	18	67.27	749.78	2,503.90	-636.29	-1,814.24	1.18	2.42	296.16

Results here appear fairly impressive. Below is an equity curve that was created using a 3-day holding strategy.



The last instance at the end of July did poorly, and it got worse over the next several days as US debt was hit with a ratings downgrade. Still, the curve appears consistent enough to confirm the bullish tendency.

Perhaps the most compelling study tonight is the one below. It looked at QQQ pullbacks that became overextended. It was last seen in the 8/5/11 letter and has also been updated.

QQQ posts a lower low for at least the 5th day in a row. It also suffers the largest 1-day drop of the selloff. Buy on close. Sell X Days later. \$100k/trade. 1999 - 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
20	167,633.30	19	18	1	94.74	9,585.08	32,613.12	-4,898.20	-4,898.20	1.96	35.22	8,822.81
19	164,935.54	19	18	1	94.74	9,425.18	30,936.87	-4,717.74	-4,717.74	2.00	35.96	8,680.82
18	160,854.31	19	18	1	94.74	9,287.24	31,433.04	-6,316.10	-6,316.10	1.47	26.47	8,466.02
17	132,798.75	19	17	2	89.47	8,156.11	26,404.29	-2,927.60	-5,542.70	2.79	23.68	6,989.41
16	120,425.53	19	16	3	84.21	8,089.16	25,733.79	-3,000.32	-6,728.58	2.70	14.38	6,338.19
15	98,482.40	19	16	3	84.21	7,214.21	22,716.54	-5,648.30	-9,255.02	1.28	6.81	5,183.28
14	121,403.66	19	16	3	84.21	8,342.95	26,404.29	-4,027.86	-7,012.16	2.07	11.05	6,389.67
13	105,085.38	19	16	3	84.21	7,283.00	21,710.79	-3,814.20	-6,367.66	1.91	10.18	5,530.81
12	98,451.90	19	15	4	78.95	7,717.66	25,733.79	-4,328.24	-7,310.16	1.78	6.69	5,181.68
11	84,041.83	19	13	6	68.42	8,213.36	25,063.29	-3,788.65	-7,642.44	2.17	4.70	4,423.25
10	84,678.45	19	14	5	73.68	7,720.93	25,653.33	-4,682.93	-7,916.35	1.65	4.62	4,456.76
9	91,462.71	19	13	6	68.42	8,364.94	22,381.29	-2,880.26	-7,115.10	2.90	6.29	4,813.83
8	87,319.28	19	13	6	68.42	7,787.20	25,881.30	-2,319.06	-8,717.60	3.36	7.28	4,595.75
7	79,695.26	19	15	4	78.95	6,452.87	25,572.87	-4,274.45	-8,108.65	1.51	5.66	4,194.49
6	76,189.96	19	15	4	78.95	6,000.07	17,191.62	-3,452.77	-6,667.47	1.74	6.52	4,010.00
5	46,390.68	19	12	7	63.16	5,024.18	12,677.42	-1,985.63	-5,095.95	2.53	4.34	2,441.61
4	38,768.61	19	10	9	52.63	6,089.12	14,844.87	-2,458.07	-9,647.05	2.48	2.75	2,040.45
3	26,653.08	19	11	7	57.89	4,162.24	11,487.50	-2,733.07	-7,147.15	1.52	2.39	1,402.79
2	34,546.77	21	14	7	66.67	3,649.36	15,625.00	-2,363.47	-6,608.68	1.54	3.09	1,645.08
1	38,601.87	21	15	6	71.43	2,972.20	12,187.50	-996.85	-2,243.50	2.98	7.45	1,838.18

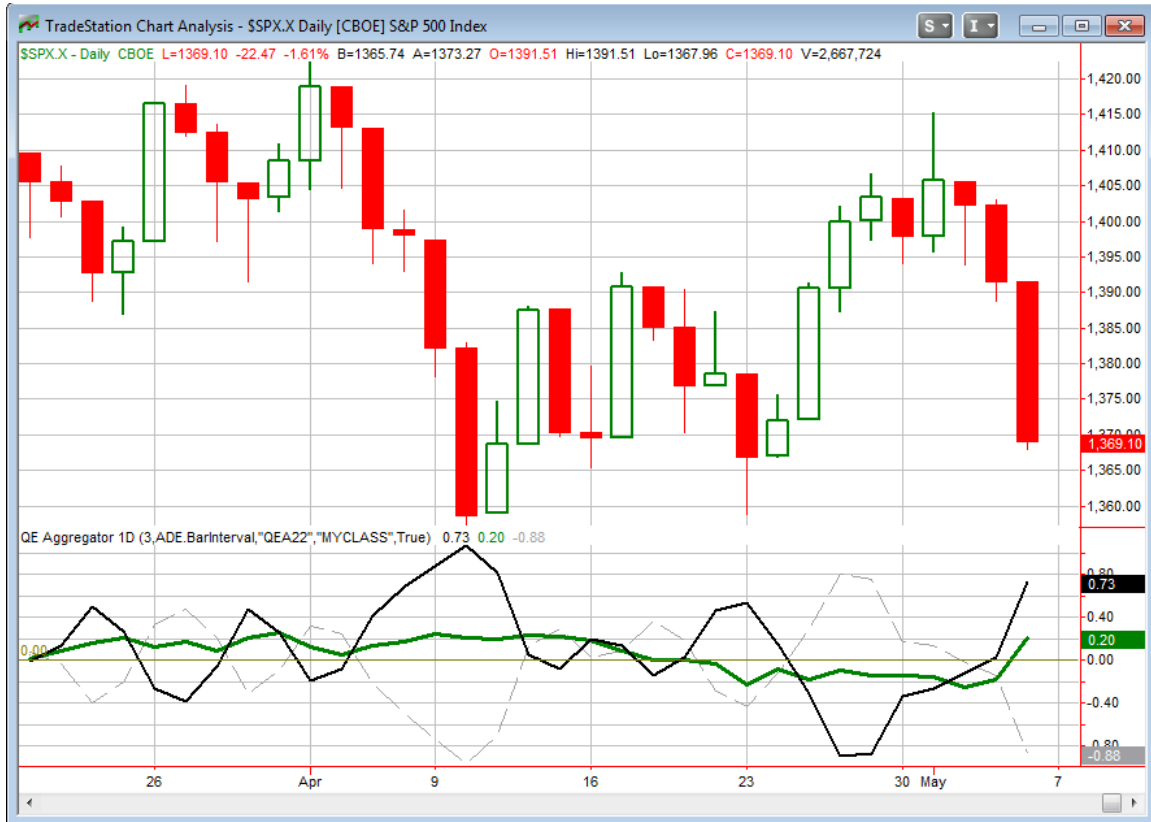
These very simple requirements have led to some very strong results. Four weeks out the average trade has produced a gain in the QQQ of nearly 9%. Often the outsized gains were partially due to the volatile environment that was present when the study triggered. Many of these occurred during the wild 2000 – 2002 bear market in the Nasdaq. Below I have listed all instances with a 20-day holding period.

QQQ posts a lower low for at least the 5th day in a row.  
 It also suffers the largest 1-day drop of the selloff.  
 Buy on close. Sell X Days later. \$100k/trade. 1999 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
01/28/00	Buy	\$86.00	20.93%	\$24,983.00
02/28/00	Sell	\$104.00		(\$2,905.00)
04/14/00	Buy	\$80.00	10.39%	\$21,100.00
05/15/00	Sell	\$88.31		(\$2,500.00)
05/23/00	Buy	\$74.56	32.62%	\$33,739.56
06/21/00	Sell	\$98.88		(\$3,097.71)
07/28/00	Buy	\$86.75	13.00%	\$15,206.40
08/25/00	Sell	\$98.03		(\$3,962.88)
09/17/01	Buy	\$31.20	10.26%	\$12,980.25
10/15/01	Sell	\$34.40		(\$13,461.00)
01/16/02	Buy	\$38.78	(4.90%)	\$3,067.82
02/14/02	Sell	\$36.88		(\$9,822.18)
02/21/02	Buy	\$33.48	10.57%	\$17,050.06
03/21/02	Sell	\$37.02		(\$1,164.54)
04/26/02	Buy	\$31.04	0.64%	\$8,342.39
05/24/02	Sell	\$31.24		(\$8,439.02)
07/23/02	Buy	\$22.40	12.46%	\$14,240.16
08/20/02	Sell	\$25.19		(\$4,910.40)
09/23/02	Buy	\$21.02	15.56%	\$16,316.51
10/21/02	Sell	\$24.29		(\$5,993.82)
12/09/02	Buy	\$25.22	2.70%	\$6,780.15
01/08/03	Sell	\$25.90		(\$3,727.10)
03/10/03	Buy	\$24.01	8.66%	\$14,032.68
04/07/03	Sell	\$26.09		(\$1,957.08)
12/09/03	Buy	\$34.43	10.31%	\$10,367.28
01/08/04	Sell	\$37.98		(\$871.20)
08/06/04	Buy	\$32.72	4.34%	\$6,600.96
09/03/04	Sell	\$34.14		(\$1,130.72)
01/14/09	Buy	\$28.63	6.78%	\$10,650.60
02/12/09	Sell	\$30.57		(\$2,339.64)
06/29/10	Buy	\$43.37	6.18%	\$7,721.75
07/28/10	Sell	\$46.05		(\$3,688.00)
11/12/10	Buy	\$52.51	3.41%	\$4,245.92
12/13/10	Sell	\$54.30		(\$2,437.12)
04/08/11	Buy	\$56.95	3.06%	\$4,194.45
05/09/11	Sell	\$58.69		(\$2,860.65)
08/04/11	Buy	\$54.17	0.72%	\$2,898.22
09/01/11	Sell	\$54.56		(\$7,827.04)

The last few instances have not exhibited the kind of strength shown in the past, but there still appears to be a substantial upside edge. I should also not that the short-term results (6-day) have had a more substantial fade than the long-term. Being that this was based on a similar premise as the previous SPX study, I elected to leave it out of the Aggregator. I am using it as part of my overall considerations though as you will see later on.

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



Tonight's studies caused the green Aggregator line to flip back positive. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile Friday's big selloff caused the black Differential Line to shoot up well above zero. This suggests the SPX is strongly short-term oversold versus expectations. So net expectations are bullish and the SPX is oversold 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 changed from flat to long at the close. This was indicated as likely on the systems page shortly before the bell.

Based on the current studies, expectations will remain positive on Monday. Of course this could easily change if is strong bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,394.03 on Monday. This is a 1.8% above Friday's close. It is highly unlikely we see a 1-day pop of this magnitude. A more likely scenario is a multi-day rally or consolidation that would wear off the oversold condition.

It took 3 days of selling but the market finally produced a few short-term bullish studies. Based on the evidence, probabilities are now pointing towards a bounce. QQQ is more oversold than SPX and the QQQ study above makes it a more appealing option in my eyes. Therefore, I will look begin scaling into a long position in QQQ.

If the market continues to pull back and we see further evidence of a likely bounce then I will scale in further over the next few days. I'll note that a close near the low end of its recent range on Wednesday would trigger a long signal for the QE Buying Power swing system. That would provide a nice bit of evidence for a 2<sup>nd</sup> or (less likely) a 3<sup>rd</sup> entry. It is highly unlikely that I will take on a full 4-lot position as long as my intermediate-term outlook remains neutral.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 5/7 – neutral***

After flirting with the April highs as recently as Tuesday, the major indices are now testing the April lows. If those fail to hold we could see a quick selloff as people react to the apparent shift in direction.

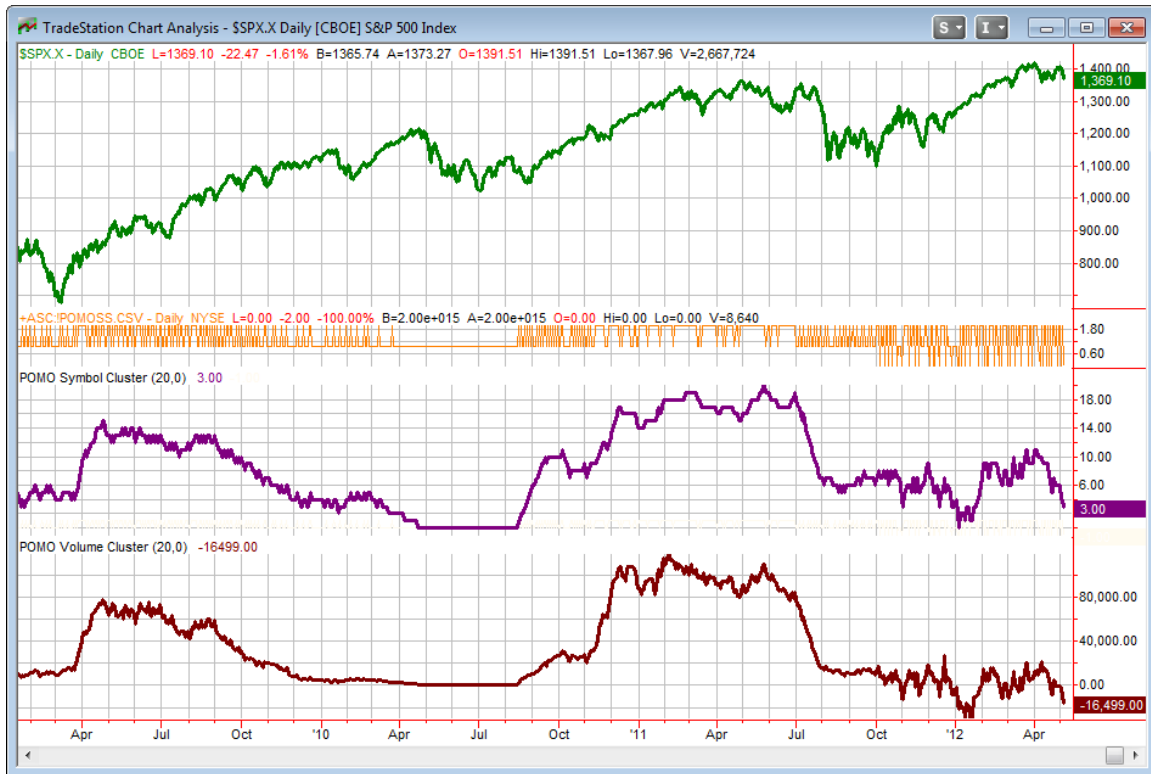
For the 3<sup>rd</sup> week in a row the Nasdaq/SPX relative strength model flipped its signal. This time it swung back to where the SPX is leading. Since the inception of the Nasdaq, the SPX has gained 1,408 points when then Nasdaq was in leading position and has lost ground when the SPX is leading. The indicator has been less consistent over the last few years, but I would still prefer to see a leading Nasdaq. 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>



There were 3 days of POMO buying and 2 days of selling this past week, the net result was a moderate \$1.6 billion outflow. The intermediate-term POMO indicators dropped further and are now near the low end of their recent range. Over the last 4 weeks liquidity has been negative. The SPX has struggled over this period and is now approaching its lowest levels. The Nasdaq is already posting 1-month lows.

This upcoming week isn't going to be much better. There will be 4 days of small buying and 1 day of strong selling. The net result is expected to be an outflow of about \$1 billion. Interestingly, we will see the QE Buying Power Index hit 3 on both Wednesday and Friday. And the net 5-day flows should also show positive reading on those days. So while the intermediate-term indicators are weak, there could be some short-term buying opportunities approaching.

Overall, intermediate-term evidence is again mixed. Weak POMO readings, weak net new highs, and possible negative impacts from rising interest rates are all possible concerns. On the bullish side the long-term trend, the breadth thrust in March, and

tonight's overdone QQQ study are all worth considering. I remain neutral. I'm not seeing compelling enough evidence to produce strong a conviction about the intermediate-term either way. 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.*

***QQQ – buy ¼ index position @ \$64.70 LIMIT.*** Based on the short-term outlook above, I am looking to begin scaling in to a long position.

### **Current Open Trade Ideas**

*None*

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