

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 17, 2012

Volume 5 Issue 95

Market Overview



Signals Overview

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

Tonight's Research Points

- 4 lower lows and a 20-day low suggest a short-term upside edge.
- SPX 2-period RSI < 2 and a 50-day closing low suggest a 1-2 day bounce.
- 5 closes in the bottom 1/3 of its range is rare and has always been followed by a higher close 2 days later.

Short-term Outlook

The Bottom Line

Bullish evidence continues to build. The CBI is now moderately bullish as well. I am getting very close to adding more long index exposure, but am still wary of the abnormal conditions.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
May 17, 2012	SPY closes in bottom 1/3 for 5 days	1-2 days	Bullish	1.80%
May 17, 2012	4 lower lows 20-low	1-8 days	Bullish	2.40%
May 17, 2012	RSI2 < 2. 50-day low	1-2 days	Bullish	2.60%
May 16, 2012	HV 20 lows. No SPX highs	1-5 days	Bearish	-2.50%
May 16, 2012	3 20-day lows > 200ma	1-4 days	Bullish	2.40%
May 16, 2012	VIX spike to 50-high	1-2 days	Bullish	
May 9, 2012	20-day low close > 200ma	1-7 days	Bullish	2.00%
Active - Long Term				
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	

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

The Evidence

Wednesday saw more selling. The SPX lost 0.4% while the Nasdaq and the Russell 2000 each declined 0.7%. Breadth was again negative as the NYSE Up Issues % came in at 32% and the Up Volume % was 29%. Total NYSE volume rose a bit from Tuesday's level but did not reach an extreme.

Several studies appeared in the Quantifinder suggesting this pullback is nearing at least a temporary bottom. Below are some of the more compelling studies that triggered.

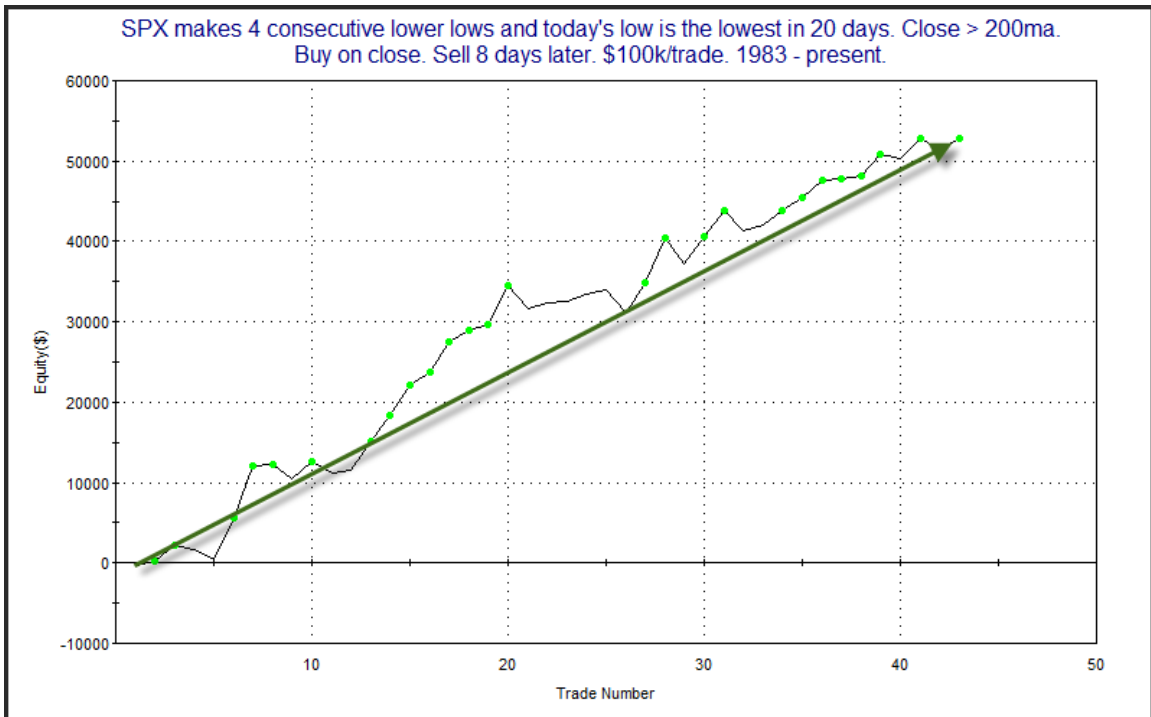
This first one considers the continually lower lows we've been seeing. It last appeared in the 7/29/11 subscriber letter. I have updated all stats below.

SPX makes 4 consecutive lower lows and today's low is the lowest in 20 days. Close > 200ma.
Buy on close. Sell X days later. \$100k/trade. 1983 - present.

X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Max Winning Trade	All: Max Losing Trade	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	48,597.69	43	30	13	69.77	5,268.12	-3,910.79	2,202.84	-1,345.20	1.64	3.78	1,130.18
9	50,159.76	43	32	11	74.42	6,263.40	-3,859.20	2,161.71	-1,728.63	1.25	3.64	1,166.51
8	52,776.43	43	32	11	74.42	6,529.38	-3,075.97	2,230.63	-1,691.25	1.32	3.84	1,227.36
7	49,654.05	43	29	14	67.44	5,954.52	-2,637.75	2,172.30	-953.04	2.28	4.72	1,154.75
6	41,354.38	44	33	11	75.00	5,148.00	-3,084.00	1,668.56	-1,246.18	1.34	4.02	939.87
5	29,204.12	44	28	16	63.64	3,689.40	-3,056.25	1,673.10	-1,102.66	1.52	2.66	663.73
4	26,545.08	44	27	17	61.36	3,847.44	-1,828.50	1,599.29	-978.57	1.63	2.60	603.30
3	12,493.39	44	24	20	54.55	3,939.79	-2,708.81	1,255.94	-882.45	1.42	1.71	283.94
2	12,779.73	44	25	19	56.82	2,794.56	-1,962.36	1,038.35	-693.63	1.50	1.97	290.45
1	2,761.20	44	28	16	63.64	1,424.76	-1,949.22	610.55	-895.88	0.68	1.19	62.75

39 of 44 instances (89%) closed above the entry price at some point in the next week.

Results above suggest a solid bullish short-term edge. To see how it has played out over the years I have included below an equity curve assuming an 8-day exit strategy.



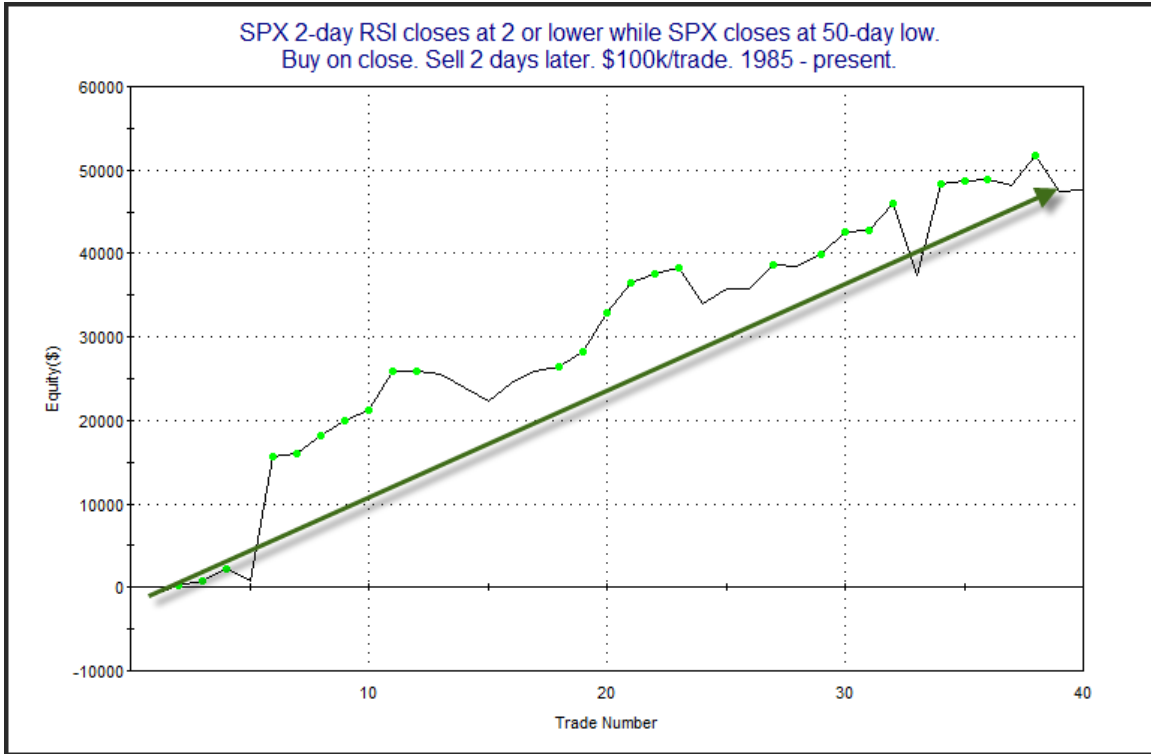
The strong, steady rise helps to confirm the upside edge suggested by the stats table.

I like using short-term RSI to measure overbought and oversold. I have found the 2-period and 3-period RSI to be especially useful. The 2-period RSI for the SPX closed at 1.36 on Wednesday. Combined with the 50-day low, this triggered the below study, which I last discussed in the 8/3/11 subscriber letter. All stats are updated.

SPX 2-day RSI closes at 2 or lower while SPX closes at 50-day low. Buy on close. Sell X days later. \$100k/trade. 1985 - present												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Max Winning Trade	All: Max Losing Trade	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	12,611.52	35	24	11	68.57	9,572.31	-27,309.65	3,155.73	-5,738.73	0.55	1.20	360.33
4	33,729.11	36	26	10	72.22	10,385.16	-10,632.61	2,637.90	-3,485.62	0.76	1.97	936.92
3	40,205.41	36	26	10	72.22	10,398.48	-4,879.68	2,352.14	-2,095.01	1.12	2.92	1,116.82
2	47,596.00	40	30	10	75.00	14,891.76	-8,657.72	2,389.07	-2,407.61	0.99	2.98	1,189.90
1	47,394.57	51	36	15	70.59	11,558.43	-7,577.02	2,023.00	-1,695.55	1.19	2.86	929.31

Only 1 instance failed to close above the entry price at some point in the next 4 days. It occurred on 3/25/94.

The positive implications are primarily seen in the first 2 days. And while we often see studies with larger expectancies, the consistency of this one has been remarkable. I say this because of the stat noted in red at the bottom of the table.



The consistency of the edge is also demonstrated by this equity curve.

Regardless of whether the market has closed up or down, SPY has consistently closed near the lower end of its range over the last 5 days. Below is a list of all the instances where SPY closed in the bottom third of its daily range for five days in a row, and their returns over the next two days.

SPY closes in the bottom 33% of its daily range for the 5th day in a row.
Buy on close. Sell 2 days later. \$100k/trade. 1993 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
07/22/02	Buy	\$82.20	3.07%	\$3,550.72
07/24/02	Sell	\$84.72		(\$5,496.32)
01/05/05	Buy	\$118.01	0.36%	\$1,033.34
01/07/05	Sell	\$118.44		\$0.00
01/25/05	Buy	\$116.88	0.47%	\$743.85
01/27/05	Sell	\$117.43		\$0.00
03/29/05	Buy	\$116.53	1.23%	\$1,655.94
03/31/05	Sell	\$117.96		\$0.00
12/21/05	Buy	\$126.03	0.58%	\$658.19
12/23/05	Sell	\$126.76		\$0.00
12/19/11	Buy	\$120.29	3.23%	\$3,382.17
12/21/11	Sell	\$124.17		\$0.00

Avg gain: 1.5%

What I find most remarkable about this study is not the fact that all 6 instances closed higher 2 days later, but that the last 5 never saw any drawdown over the next 2 days. That means they gapped up on day 1 and went 2 days without filling. Instances are low, but results are so lopsided I decided to include this on the Active List.

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



With tonight's studies factored in the green Aggregator line shot up even further. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line is very far above zero. This means the SPX is 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 remained 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 Thursday. Of course this could change if strong bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,346.15 on Thursday. This is 1.6% above Wednesday's close. That means it will take a big move on Thursday to flip the differential line into negative territory. A 1-day rally of this magnitude is unlikely. A more likely scenario would be a multi-day rise or consolidation that would work off the oversold condition.

Evidence tonight was quite compelling, and I was very tempted to add to my long index position, which is still just ½ size. In the end I decided I will give it one more day. If the market declines again tomorrow I will almost certainly be a buyer of another ¼ size lot on Friday. There were 2 more Catapult triggers on Wednesday and I will look to enter

them Thursday. This brings the CBI up to 5, which is considered a moderately bullish number. It could potentially reach 7 or 8 tomorrow if there is another down day. As many readers are likely aware, 10 or higher I consider to be strongly bullish. I will not take on a full-size index position at this point unless we reach a CBI of at least 10. While evidence continues to build, the length and persistency of this selloff and the inability of the market to muster even a short-term bounce all suggest conditions are abnormal and caution is warranted. Hence, my conservative position sizing to this point.

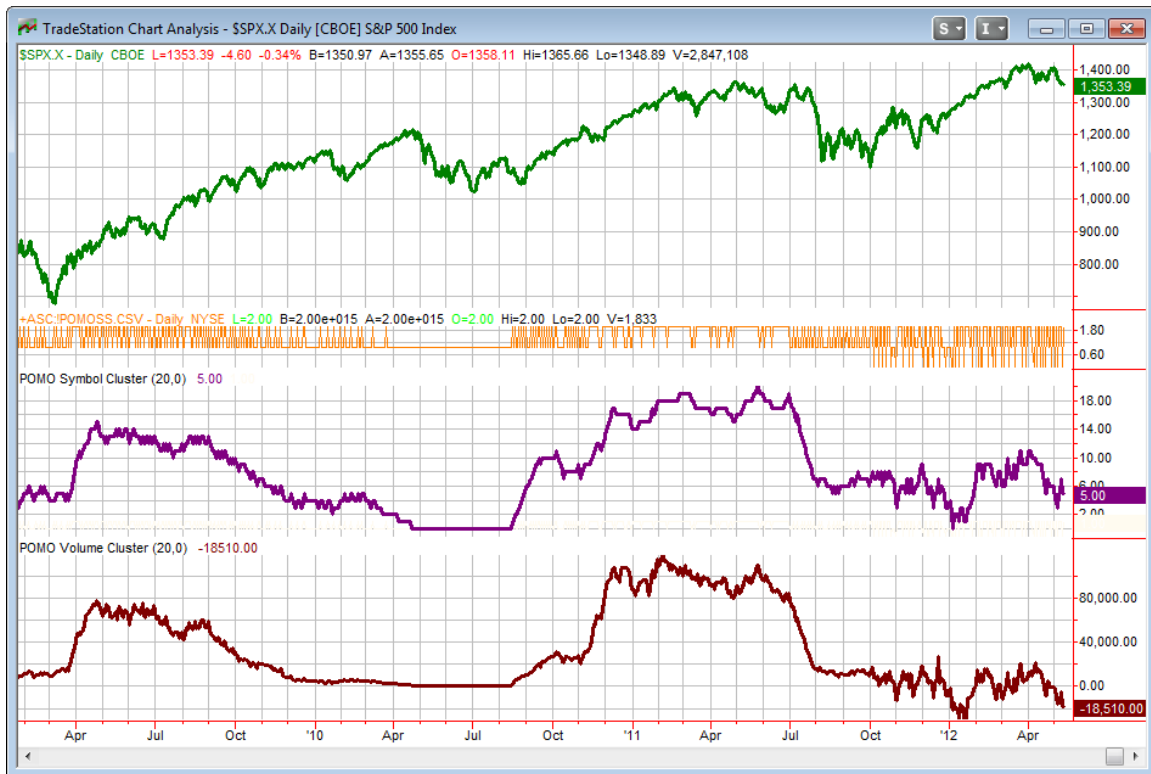
Intermediate-term Outlook (2 weeks – 2 months)– updated 5/14 – neutral

The market came in to the week extremely oversold and failed to alleviate that condition. It closed Friday at the lowest level in over 2 months, and it is going to take some work to re-establish the uptrend and make new highs.

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>



There were 4 days of POMO buying and 1 day of selling this past week, but the net result was a moderate \$1 billion liquidity injection. The intermediate-term POMO indicators dropped further and are now at the lowest levels in months. Liquidity measures topped out in early April along with the market. Since then we've seen negative POMO flows and negative stock returns. This should not surprise anyone.

The correlation between POMO flows and market returns has been strong since 2005 when POMO data first became available. The 1st period where it got strongly out of whack was from December through February. At the time we noted that while POMO was negative, the Fed was aggressively increasing liquidity through swap transactions with European banks. It appeared that this may have provided stimulus for the rally. This stimulus has been unwinding over the last couple of months, and with POMO negative since early April the stock market has struggled.

This upcoming week the Fed is scheduled for 3 days of buying and 1 day of selling. This should net out to near a \$3 billion inflow. The short-term QE Buying Power Index is at 3 right now (and the QE Buying Power swing system is long). Three or higher is considered bullish, while 0 or below is considered bearish. On Tuesday it will dip to 1 before reaching 0 on Wednesday and then finish Thursday and Friday at 2. All this means is that short-term flows are expected to have a positive market influence for the next couple of days, but beyond that things will again become sketchy. The swing system long signal will expire on Thursday if the market fails to bounce before then.

More details on the QE Buying Power Index and swing system, including the full May projections, are available to subscribers on the QE Buying Power Index page, which can be linked to below:

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

Intermediate-term evidence continues to remain mixed. Weak POMO readings, weak net new highs, new 40-day lows, 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 last week'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

HD – 1/3 @ \$50.11 (not filled and now temporarily off the table)

CAT – 1/3 @ \$93.61 (bought @ limit)

CAT – 1/3 @ \$92.68 (bought @ limit)

New

CAT – 1/3 @ \$91.86 (buy @ limit)

APA – 1/3 @ \$82.12 (buy @ limit)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 3/2 (HD, CAT-3, APA)

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.

CAT – buy 1/3 Catapult position @ \$91.86 limit. - This is based on the catapult signal listed above in the Catapult & CBI section. It is the 3rd and final lot.

APA – buy 1/3 Catapult position @ \$82.12 limit. - This is based on the catapult signal listed above in the Catapult & CBI section. It is the 3rd and final lot.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
QQQ(1/4)	5/7/2012	\$64.31	\$62.94	-2.13%		Aggregator
SPY(1/4)	5/9/2012	\$135.74	\$132.83	-2.14%		Aggregator
CAT(1/3)	5/15/2012	\$93.61	\$91.86	-1.87%		Catapult
CAT(1/3)	5/16/2012	\$92.68	\$91.86	-0.88%		Catapult

This report has been prepared by Hanna Capital Management, LLC and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy securities. While information contained herein is believed to be accurate at the time of publication, we make no representation as to the accuracy or completeness of any data, studies, or opinions expressed and it should not be relied upon as such. Robert Hanna, Hanna Capital Management, LLC or clients of Hanna Capital Management, LLC may have positions or other interests in securities (including derivatives) directly or indirectly which are the subject of this report. This report is provided solely for the information of Hanna Capital Management, LLC clients and prospects who are expected to make their own investment decisions without reliance upon this report. Neither Hanna Capital Management, LLC nor any officer or employee of Hanna Capital Management, LLC accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report may not be reproduced, distributed or published by any recipient for any purpose without the prior express consent of Hanna Capital Management, LLC.

Copyright © 2012 Hanna Capital Management, LLC.