

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 18, 2012

Volume 5 Issue 96

Market Overview



Signals Overview

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

Tonight's Research Points

- The CBI, the McClellan Oscillator, the NYSE closing TICK, price action and volume are all suggesting the market is way oversold and there is a strong upside edge.

Short-term Outlook

The Bottom Line

It appears we are entering the washout phase of the selloff. I am upping my exposure in anticipation of the bounce.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
May 18, 2012	SPX low. TICK closing low.	1 day	Bullish	
May 18, 2012	Down 3+ days. Big drop. High vol.	1-5 days	Bullish	
May 18, 2012	CBI/McOsc overdone	1-5 days	Bullish	
May 18, 2012	RSI ₂ <2. 50-day low. Twice	1-3 days	Bullish	
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 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%
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	
Dropped Tonight				
May 9, 2012	20-day low close > 200ma	1-7 days	Bullish	2.00%

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

The Evidence

The selling intensified on Thursday as major indices saw large losses. The SPX lost 1.5% while the Nasdaq declined 2.1% and the Russell 2000 fell 2.3%. Breadth was very strongly negative as the NYSE Up Issues % came in at 13% and the Up Volume % was 11%. Total NYSE volume spiked to the highest level since April 20th.

Each night I have been harping on the fact that market conditions are currently abnormal. Last week the market reached oversold levels that almost always result in a bounce. When that bounce did not come it suggested caution was warranted. While bullish studies continued to unveil themselves over the last several days, the fact that we are in an abnormal market did not change. Abnormal markets are extremely tricky to trade and I typically only like to get aggressive when it appears there is a washout occurring. Until Thursday we really have not seen any signs of washout selling. Capitulation was not evident. But Thursday, for the first time, it appears we are seeing early signs of capitulation. Breadth (including the CBI), the closing TICK reading, price action, and volume are all showing extreme behavior that has typically suggested a strong upside edge. Below are some of the more compelling studies I examined tonight.

The Quantifiable Edges Capitulative Breadth Index (CBI) closed at 7 on Thursday. For years I have viewed 7 and 10 as key CBI levels. A CBI of 7 has generally suggested a decent upside edge, while 10 or higher has suggested a strong upside edge. The CBI will

only typically rise to levels of 7 or higher during sharp market pullbacks. I decided tonight to examine results following CBI readings between 7 and 10. But tonight for the first time I am breaking out results by whether the market is above or below its long-term moving average.

First let's look at times, unlike the present, when the SPX was trading below its 200ma. The stats table below looks at returns assuming you bought the close on a day where the CBI registered at least a certain number. The exit signal occurred when the CBI dropped back down to 3 or below.

CBI closes above X and SPX closes < 200ma. Buy SPX on close. Sell on CBI close <= 3. \$100k/trade. 1995 - present.												
X	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	58,024.07	18	15	3	83.33	18,981.60	-4,214.00	4,372.32	-2,520.24	1.73	8.67	3,223.56
9	57,776.50	20	14	6	70.00	18,981.60	-4,214.00	4,765.78	-1,490.74	3.20	7.46	2,888.83
8	69,004.78	29	22	7	75.86	18,981.60	-4,214.00	3,561.41	-1,335.17	2.67	8.38	2,379.48
7	68,315.21	31	23	8	74.19	18,981.60	-4,214.00	3,543.14	-1,647.12	2.15	6.18	2,203.72

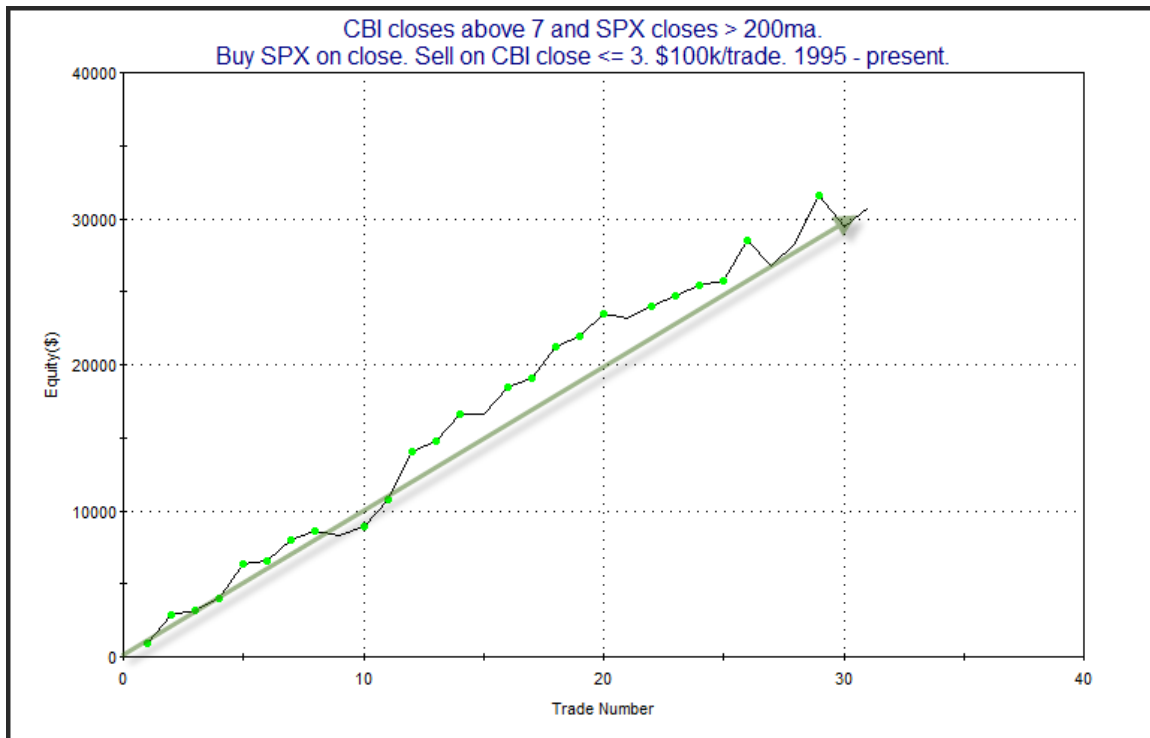
Results here are strong across the board. Most traders would agree that it might make sense to wait for a CBI reading of 10 or higher, rather than enter early with a CBI of 7. While there are 42% less trades, 85% of the net profits are still realized by waiting for a reading of 10, rather than using 7 or higher as an entry signal.

Now let's look at times like the present, where the CBI is spiking but the market is still above its 200ma.

CBI closes above X and SPX closes > 200ma. Buy SPX on close. Sell on CBI close <= 3. \$100k/trade. 1995 - present.												
X	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	8,035.35	8	8	0	100.00	2,338.56	0.00	1,004.42	0.00	100.00	100.00	1,004.42
9	13,376.54	14	12	2	85.71	2,826.73	-1,129.59	1,213.22	-591.04	2.05	12.32	955.47
8	19,848.59	21	18	3	85.71	3,399.40	-2,178.16	1,324.39	-1,330.17	1.00	5.97	945.17
7	30,783.05	31	26	5	83.87	3,278.50	-2,178.16	1,363.63	-934.25	1.46	7.59	993.00

There are few things to note here. First the average trade is much lower than you see when the market is < 200ma. This is primarily because volatility is generally higher during bear markets. What's interesting is that there has been the exact same number of instances where the CBI reached seven or higher (31), but while the CBI has reached ten 18 different times when below the 200ma, it has only managed it 8 times above the 200ma. And with the average trade being almost identical regardless of whether you use 7, 8, 9, or 10, in the long run you would have made nearly 4x as much by using 7 as your trigger rather than 10. This suggests to me that it may be time to start upping my long exposure, rather than wait for a CBI of 10.

For further confirmation, I looked at the profit curve.



While not perfect, this is an impressively consistent upslope. For purposes of generating estimates I also elected to show results using a time-based exit. Those can be found below.

**CBI closes above 7 and SPX closes > 200ma.
Buy SPX on close. Sell X days later. \$100k/trade. 1995 - 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	35,270.30	26	20	6	76.92	5,639.02	-2,960.53	2,213.17	-1,498.86	1.48	4.92	1,356.55
9	28,915.56	26	19	7	73.08	4,942.24	-3,632.23	2,099.31	-1,567.33	1.34	3.64	1,112.14
8	27,947.25	27	18	8	66.67	4,399.16	-2,640.24	2,118.16	-1,272.45	1.66	3.75	1,035.08
7	25,698.01	27	21	6	77.78	4,496.68	-2,525.67	1,610.24	-1,352.83	1.19	4.17	951.78
6	30,328.85	27	21	6	77.78	4,169.62	-2,153.08	1,643.77	-698.40	2.35	8.24	1,123.29
5	31,873.58	27	21	6	77.78	3,366.82	-2,217.68	1,722.32	-715.85	2.41	8.42	1,180.50
4	25,001.69	27	19	8	70.37	3,172.16	-1,144.48	1,571.09	-606.13	2.59	6.16	925.99
3	9,096.44	27	19	8	70.37	3,278.50	-3,490.90	979.77	-1,189.89	0.82	1.96	336.91
2	2,426.34	27	14	13	51.85	1,786.56	-2,290.68	923.59	-808.00	1.14	1.23	89.86
1	5,978.12	27	18	9	66.67	1,612.80	-1,939.20	713.67	-763.10	0.94	1.87	221.41

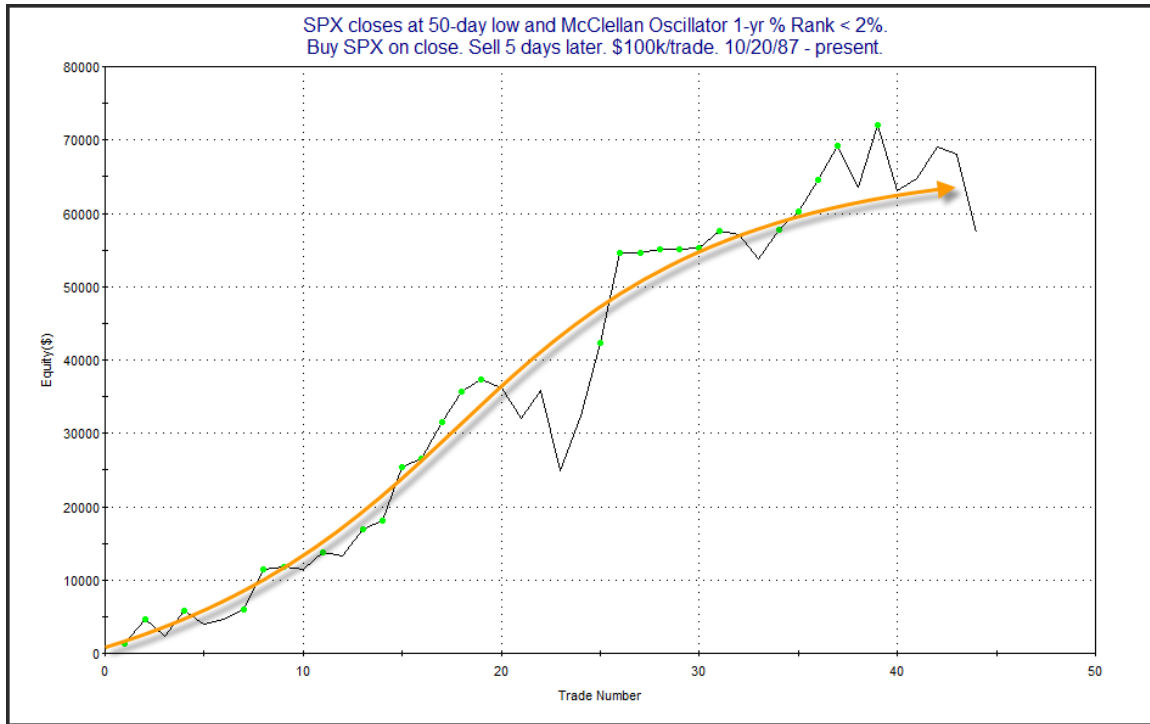
No surprise here. Over the next week numbers are quite strong.

Another, more common breadth indicator providing extreme readings is the McClellan Oscillator, which closed below 300 today. This is a very low reading, and in the bottom 2% of all readings over the last year. With the SPX also closing at a 50-day low, the study below triggered. It last appeared in the 8/3/11 Subscriber Letter, and I have updated the results.

**SPX closes at 50-day low and McClellan Oscillator 1-yr % Rank < 2%.
Buy SPX on close. Sell X days later. \$100k/trade. 10/20/87 - 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	57,015.51	44	25	19	56.82	18,981.60	-9,314.08	3,931.85	-2,172.66	1.81	2.38	1,295.81
4	36,918.23	47	29	18	61.70	17,851.68	-14,820.98	2,962.72	-2,722.26	1.09	1.75	785.49
3	31,376.12	50	33	17	66.00	13,853.40	-13,815.18	2,530.44	-3,066.39	0.83	1.60	627.52
2	40,331.11	61	37	24	60.66	13,116.84	-8,657.72	2,657.50	-2,416.52	1.10	1.70	661.17
1	43,876.56	82	51	31	62.20	11,558.43	-7,577.02	1,929.39	-1,758.79	1.10	1.80	535.08

Results here are strong, with the average gains over the next five days roughly equivalent to the average gains of the CBI study. Below is an equity curve to see how the edge has played out over time.



The curve has been somewhat choppy throughout its history, and the worst loss was the last one in August of 2011. Still, I feel results are compelling enough to warrant consideration.

My friend and colleague, Tom McClellan, taught me a while back that closing TICK values can be used as a valuable indicator. Closing TICK values tend to do a good job of representing end of day order imbalances. When the closing TICK is very weak that means there are a lot of sell orders at the end of the day. A strong closing TICK would indicate lots of buy orders coming in at the end of the day. The final flurry of buying or selling, and market participants' willingness to hold positions overnight, can act as a good sentiment gauge.

On Thursday the NYSE closing TICK was -777. This is a very low reading and it represents the lowest reading since November. The study below was last seen in the 7/28/11 Subscriber Letter. It looks at short-term SPX lows in conjunction with long-term closing TICK lows. Results have been updated.

NYSE TICK closes at 100-day low and SPX closes at 5-day low.
 Buy SPX on close. Sell 1 day later. \$100k/trade. 7/1/98 - present.

TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	\$33,067.15	Profit Factor	10.48
Gross Profit	\$36,553.98	Gross Loss	(\$3,486.83)
Total Number of Trades	27	Percent Profitable	85.19%
Winning Trades	23	Losing Trades	4
Even Trades	0		
Avg. Trade Net Profit	\$1,224.71	Ratio Avg. Win:Avg. Loss	1.82
Avg. Winning Trade	\$1,589.30	Avg. Losing Trade	(\$871.71)
Largest Winning Trade	\$4,723.23	Largest Losing Trade	(\$1,506.56)

The July 2011 instance was a loser, but the numbers are still all overwhelmingly bullish. In that same subscriber letter I also filtered on instances that occurred above the 200ma. I've updated those results below, showing all of the individual occurrences.

NYSE TICK closes at 100-day low and SPX closes at 5-day low. SPX > 200ma.
Buy SPX on close. Sell 1 day later. \$100k/trade. 7/1/98 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
08/04/98	Buy	\$1,072.12	0.87%	\$1,179.24
08/05/98	Sell	\$1,081.42		(\$1,374.54)
05/25/99	Buy	\$1,284.38	1.59%	\$1,574.65
05/26/99	Sell	\$1,304.76		(\$450.45)
08/30/99	Buy	\$1,324.02	(0.27%)	\$694.50
08/31/99	Sell	\$1,320.41		(\$1,283.25)
07/17/03	Buy	\$981.73	1.18%	\$1,264.52
07/18/03	Sell	\$993.32		(\$3.03)
02/04/04	Buy	\$1,126.53	0.18%	\$408.32
02/05/04	Sell	\$1,128.61		(\$183.92)
03/10/04	Buy	\$1,123.91	(1.52%)	\$180.40
03/11/04	Sell	\$1,106.79		(\$1,587.52)
05/10/04	Buy	\$1,087.12	0.77%	\$779.87
05/11/04	Sell	\$1,095.49		\$0.00
02/22/05	Buy	\$1,184.17	0.56%	\$785.40
02/23/05	Sell	\$1,190.80		\$0.00
02/27/07	Buy	\$1,399.14	0.55%	\$1,189.25
02/28/07	Sell	\$1,406.82		(\$176.79)
03/05/07	Buy	\$1,374.12	1.55%	\$1,712.16
03/06/07	Sell	\$1,395.41		\$0.00
06/07/07	Buy	\$1,490.72	1.14%	\$1,141.68
06/08/07	Sell	\$1,507.67		(\$221.77)
07/27/07	Buy	\$1,458.95	1.03%	\$1,287.24
07/30/07	Sell	\$1,473.91		(\$314.84)
02/04/10	Buy	\$1,063.11	0.29%	\$377.88
02/05/10	Sell	\$1,066.19		(\$1,749.34)
06/08/11	Buy	\$1,279.56	0.74%	\$1,168.44
06/09/11	Sell	\$1,289.00		\$0.00
07/27/11	Buy	\$1,304.89	(0.32%)	\$868.68
07/28/11	Sell	\$1,300.67		(\$435.48)
Avg trade: \$551				

As is often the case, instances above the 200ma have showed less volatility than those below it. Still, the numbers appear impressive.

But of course the market is not simply at a 5-day low. It is at a 50-day low. I decided to look at results using the 50-day low instead of the 5-day.

NYSE TICK closes at 100-day low and SPX closes at 50-day low.
Buy SPX on close. Sell 1 day later. \$100k/trade. 7/1/98 - present.

TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	\$18,390.92	Profit Factor	14.24
Gross Profit	\$19,779.72	Gross Loss	(\$1,388.80)
Total Number of Trades	12	Percent Profitable	91.67%
Winning Trades	11	Losing Trades	1
Even Trades	0		
Avg. Trade Net Profit	\$1,532.58	Ratio Avg. Win:Avg. Loss	1.29
Avg. Winning Trade	\$1,798.16	Avg. Losing Trade	(\$1,388.80)
Largest Winning Trade	\$4,723.23	Largest Losing Trade	(\$1,388.80)

Only one instance out of 12 here didn't close higher the next day. Bottom line no matter how I slice it is that the extreme TICK reading Thursday afternoon suggests an upside edge for Friday.

In last night's subscriber letter I looked at a study that examined what happened when the SPX closed at a 50-day low and the 2-day RSI was less than two. With today's selloff it happened again. On 7/2/10 I looked at other instances where this combination occurred 2 days in a row. Those results are updated below.

SPX 2-day RSI < 2 and SPX closes at 50-day low. The combination occurs for the 2nd day in a row.
Buy SPX 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	25,485.20	10	6	4	60.00	13,135.00	-5,696.34	5,828.51	-2,371.47	2.46	3.69	2,548.52
4	18,574.26	10	6	4	60.00	12,657.50	-4,574.36	4,155.45	-1,589.61	2.61	3.92	1,857.43
3	27,018.79	10	9	1	90.00	9,601.81	-3,090.08	3,345.43	-3,090.08	1.08	9.74	2,701.88
2	25,706.39	10	8	2	80.00	10,183.87	-3,135.65	3,685.11	-1,887.23	1.95	7.81	2,570.64
1	14,585.46	10	6	4	60.00	5,716.25	-1,631.84	3,113.03	-1,023.17	3.04	4.56	1,458.55

Instances are a little lower than I typically like, but the numbers are incredibly bullish and seem worthy of consideration. Below I have listed all 10 instances assuming a 3-day holding period.

SPX 2-day RSI < 2 and SPX closes at 50-day low. The combination occurs for the 2nd day in a row. Buy SPX on close. Sell 3 days later. \$100k/trade. 1985 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
09/16/85	Buy	\$182.88	0.27%	\$278.46
09/19/85	Sell	\$183.38		(\$1,152.06)
03/28/94	Buy	\$460.00	(3.10%)	\$69.44
03/31/94	Sell	\$445.76		(\$5,173.28)
11/23/94	Buy	\$449.19	1.33%	\$1,327.56
11/29/94	Sell	\$455.17		\$0.00
10/12/00	Buy	\$1,329.64	1.53%	\$3,851.25
10/17/00	Sell	\$1,349.97		(\$212.25)
09/21/01	Buy	\$965.80	4.27%	\$5,612.47
09/26/01	Sell	\$1,007.04		\$0.00
04/29/02	Buy	\$1,065.45	1.79%	\$2,415.21
05/02/02	Sell	\$1,084.56		(\$185.07)
07/23/02	Buy	\$797.70	6.91%	\$7,016.25
07/26/02	Sell	\$852.84		(\$2,752.50)
10/09/08	Buy	\$909.92	9.68%	\$14,648.51
10/14/08	Sell	\$998.01		(\$7,643.08)
02/23/09	Buy	\$743.33	1.28%	\$4,929.86
02/26/09	Sell	\$752.83		\$0.00
07/01/10	Buy	\$1,027.37	3.20%	\$3,251.44
07/07/10	Sell	\$1,060.27		(\$1,109.68)

No red flags here.

As I mentioned earlier, another possible sign that a washout has begun is coming from the high-volume that accompanied today's selloff. The study below was last seen in the 7/28/11 subscriber letter. Stats here have also been updated.

SPX closes down for at least the 3rd day in a row. Today is the largest decline of the last 3 days. NYSE volume rises the last 3 days. SPX > 200ma.
Buy on close. Sell X days later. \$100k/trade. 1995 - 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	26,321.64	13	11	2	84.62	7,070.28	-3,385.80	2,864.05	-2,591.46	1.11	6.08	2,024.74
4	20,015.65	13	10	3	76.92	4,731.13	-3,863.84	2,739.28	-2,459.05	1.11	3.71	1,539.67
3	18,220.26	13	10	3	76.92	3,574.08	-1,364.20	2,070.54	-828.37	2.50	8.33	1,401.56
2	17,310.35	13	10	3	76.92	4,809.66	-958.36	1,925.36	-647.75	2.97	9.91	1,331.57
1	10,820.15	13	9	4	69.23	5,117.46	-1,519.76	1,461.20	-582.67	2.51	5.64	832.32

The last instance (7/27/11) was the only one that did not post a close above the entry price on day 1 or 2. It was followed by a sharp decline over the next 2 weeks.

Here too the instances are fairly light, but the statistics are strongly bullish. This appears to suggest an upside edge. For those that would prefer a closer look I have listed all 13 instances below assuming a 5-day exit strategy.

SPX closes down for at least the 3rd day in a row. Today is the largest decline of the last 3 days. NYSE volume rises the last 3 days. SPX > 200ma. Buy on close. Sell 5 days later. \$100k/trade. 1995 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
10/27/97	Buy	\$876.97	7.07%	\$7,073.70
11/03/97	Sell	\$938.99		(\$2,473.80)
12/11/97	Buy	\$954.94	0.04%	\$2,013.44
12/18/97	Sell	\$955.30		(\$825.76)
07/23/98	Buy	\$1,139.74	0.27%	\$904.80
07/30/98	Sell	\$1,142.86		(\$1,766.10)
01/28/00	Buy	\$1,360.16	4.72%	\$5,412.22
02/04/00	Sell	\$1,424.37		(\$738.03)
03/11/04	Buy	\$1,106.79	1.40%	\$1,707.30
03/18/04	Sell	\$1,122.31		(\$376.20)
06/07/07	Buy	\$1,490.72	2.16%	\$2,393.91
06/14/07	Sell	\$1,522.97		(\$221.77)
07/18/07	Buy	\$1,546.17	(1.82%)	\$577.92
07/25/07	Sell	\$1,518.09		(\$2,716.16)
09/01/09	Buy	\$998.04	3.54%	\$3,830.00
09/09/09	Sell	\$1,033.37		(\$607.00)
05/06/10	Buy	\$1,128.15	2.60%	\$3,996.96
05/13/10	Sell	\$1,157.44		(\$2,992.00)
03/16/11	Buy	\$1,256.88	3.23%	\$3,452.30
03/23/11	Sell	\$1,297.54		\$0.00
05/05/11	Buy	\$1,335.10	1.01%	\$1,801.16
05/12/11	Sell	\$1,348.65		(\$227.18)
06/24/11	Buy	\$1,268.45	5.61%	\$5,659.68
07/01/11	Sell	\$1,339.67		(\$71.76)
07/27/11	Buy	\$1,304.89	(3.41%)	\$868.68
08/03/11	Sell	\$1,260.34		(\$5,345.08)

Observant subscribers may have noted that several of the studies shown tonight also triggered right before the big selloff in early August 2011. That's definitely true. And while it appears the washout phase of this selloff has begun, we still could have a few more days of strong selling before a big bounce ultimately occurs. For me, evidence is now strong enough that I will look to up my allocation, while still saving a small bit in case we capitulate further.

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



With tonight's studies factored in the green Aggregator line shot way up. 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 quite bullish and the SPX is strongly 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 Friday. This is highly unlikely to change. Meanwhile, the Differential Pivot will be 1,337.67 on Friday. This is 2.5% above Thursday's close. That means it will take a very big move on Friday to flip the differential line into negative territory. A 1-day rally of this magnitude is highly unlikely. A more likely scenario would be a multi-day rise or consolidation that would work off the oversold condition.

As a mentioned above, breadth, sentiment (closing TICK), price action, and volume are all suggesting capitulation is occurring and the market is likely to bounce in the next few days. Already long, I am looking to take on more long exposure to try and take advantage of this bounce. When markets get like this there are really only three kinds of trades I will

take: 1) index trades (I'm already 50% my full exposure here), 2) catapult trades, and 3) VIX-based ETF trades. I strongly considered taking a position in XIV tonight. The VIX is stretched, having closed at its highest level since December, and over 18% above its 10ma. Additionally, futures remain in contango, which is beneficial for XIV. But the contango seems tenuous and the VIX is capable of getting extremely stretched if this washout continues. So tonight I decided I will simply look to add to my index position and the catapults. If the VIX does continue to rise and contango remains in place then there is a good chance I will look to enter XIV in the next few days. Trade ideas details can be found in the Trade Ideas section near the bottom of the letter.

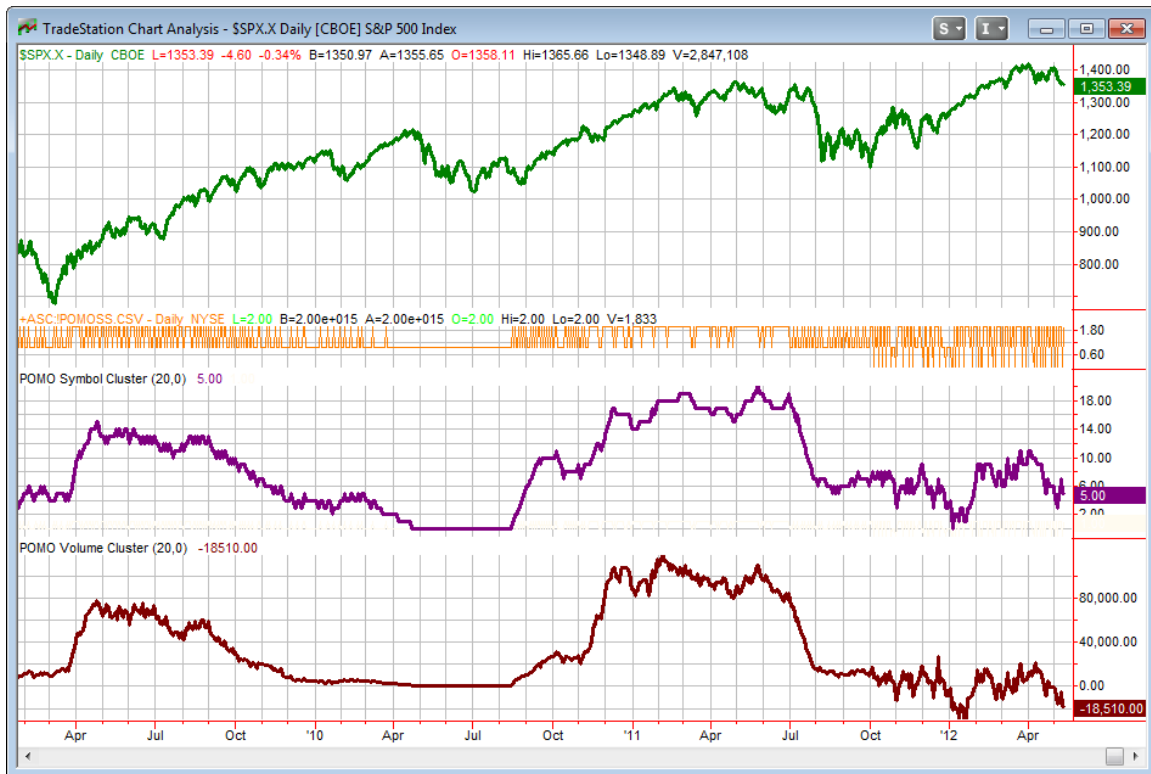
Intermediate-term Outlook (2 weeks – 2 months)– updated 5/14 – neutral

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)

CAT – 1/3 @ \$93.61 (bought)

CAT – 1/3 @ \$92.68(bought)

CAT – 1/3 @ \$91.86(bought)

APA – 1/3 @ \$82.12(bought)

New

KO – 1/3 @ \$75.08(buy @ limit)

APA – 1/3 @ \$81.67(buy @ limit)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 7/4 (HD, CAT-3, APA-2, KO)

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.

KO – buy 1/3 Catapult position @ \$75.08 limit. - This is based on the catapult signal listed above in the Catapult & CBI section. It is the 1st 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 2nd lot.

HD – buy 1/3 Catapult position @ \$47.02 limit. - This is based on the catapult signal listed above in the Catapult & CBI section. It initially went unfilled. I will look for a fill Friday.

SPY – buy 1/4 index position @ \$130.86 limit. - This is based on the short-term outlook above.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
QQQ(1/4)	5/7/2012	\$64.31	\$61.62	-4.18%		Aggregator
SPY(1/4)	5/9/2012	\$135.74	\$130.86	-3.60%		Aggregator
CAT(1/3)	5/15/2012	\$93.61	\$87.70	-6.31%		Catapult
CAT(1/3)	5/16/2012	\$92.68	\$87.80	-5.27%		Catapult
CAT(1/3)	5/17/2012	\$91.02	\$87.80	-3.54%		Catapult
APA(1/3)	5/17/2012	\$82.12	\$81.67	-0.55%		Catapult

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