

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 29, 2012

Volume 5 Issue 102

Market Overview



Signals Overview

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

Tonight's Research Points

- Memorial Day week has had bullish inclinations in the past, with Thursday being the most bullish day.
- When the Nasdaq has closed down while the SOX has risen > 1%, that has suggested a bullish bias for the next day.

Short-term Outlook

The Bottom Line

The edge appears to be to the upside, but it is a moderate edge. I am already partially long and intend to hold that position for the time being.

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

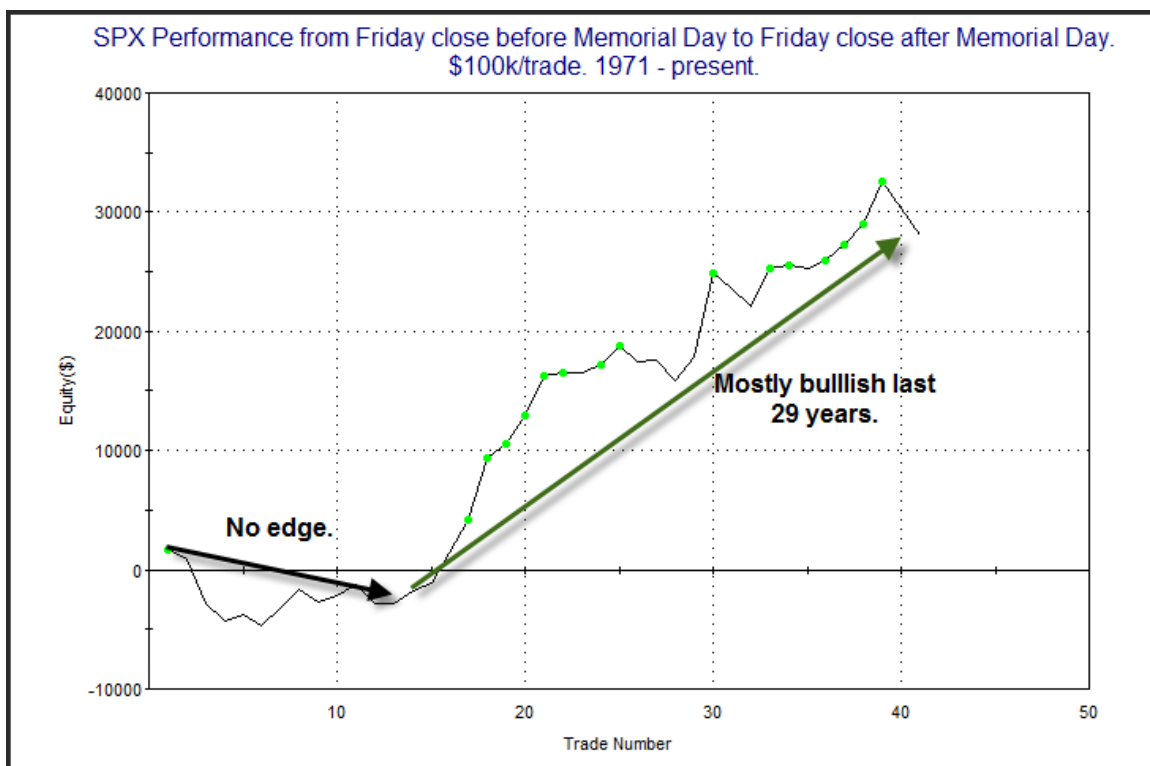
Study Date	Description	Time span	Bias	Avg Max Move
Active				
May 29, 2012	Nas down while SOX up 1%.	1 day	Bullish	
May 25, 2012	Up 3 from 50-low. Today NR7.	1-3 days	Bullish	
May 24, 2012	Up 1.5% then flat.	1-5 days	Bearish	
May 17, 2012	4 lower lows 50-low	1-8 days	Bullish	2.40%
Active - Long Term				
May 21, 2012	CBI > 10.	1-20 days	Bullish	6.80%
May 7, 2012	QQQ 5 lower lows. Today biggest drop.	1-20 days	Bullish	12.30%
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

Trading was very quiet on Friday as the indices drifted lower. The SPX declined 0.2% and the Nasdaq and Russell 2000 each lost less than 0.1%. Breadth was actually mildly positive as the NYSE Up Issues % came in at 51% and the Up Volume % was 55%. Total NYSE volume was the lowest so far in 2012.

The week of Memorial Day has shown some bullish seasonal tendencies over the years. The chart below is from the 5/31/11 subscriber letter and has been updated.



There was no substantial edge apparent throughout the 70s, but starting in 1983 you'll note a bullish tendency. Below are some performance statistics for the '83 – present timeframe.

**SPX per from Friday close before Memorial Day to Friday close after Memorial Day.
\$100k/trade. 1971 - present.**

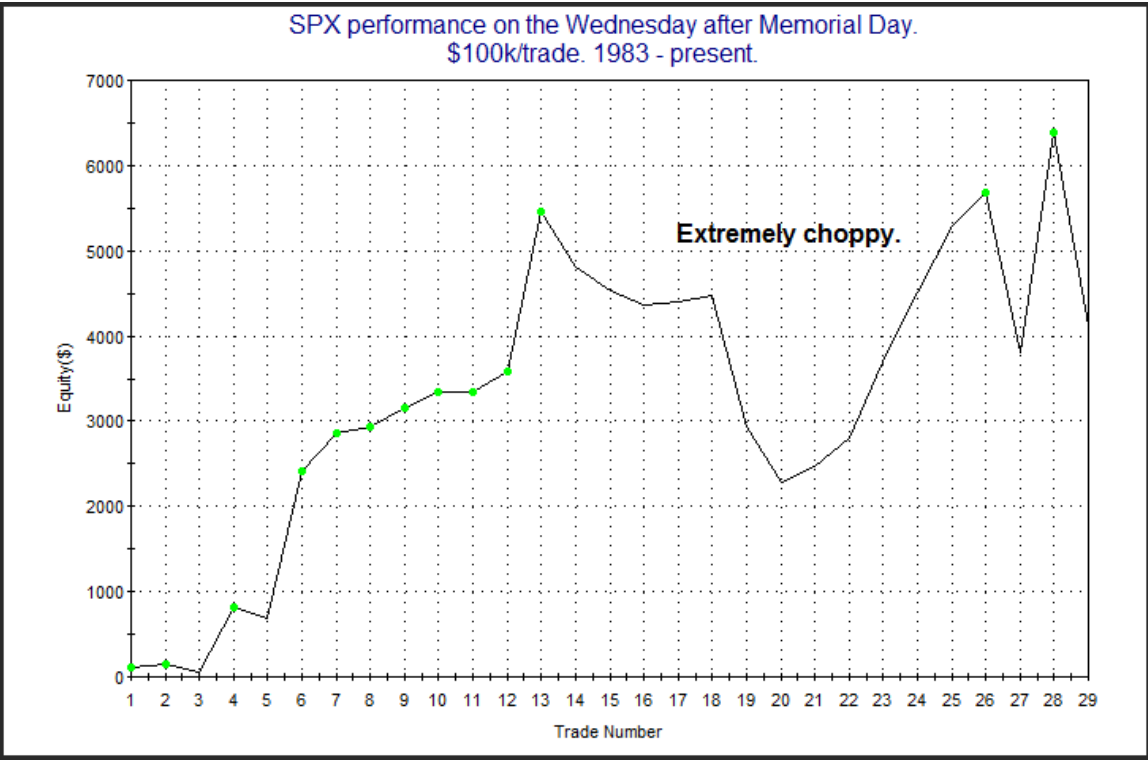
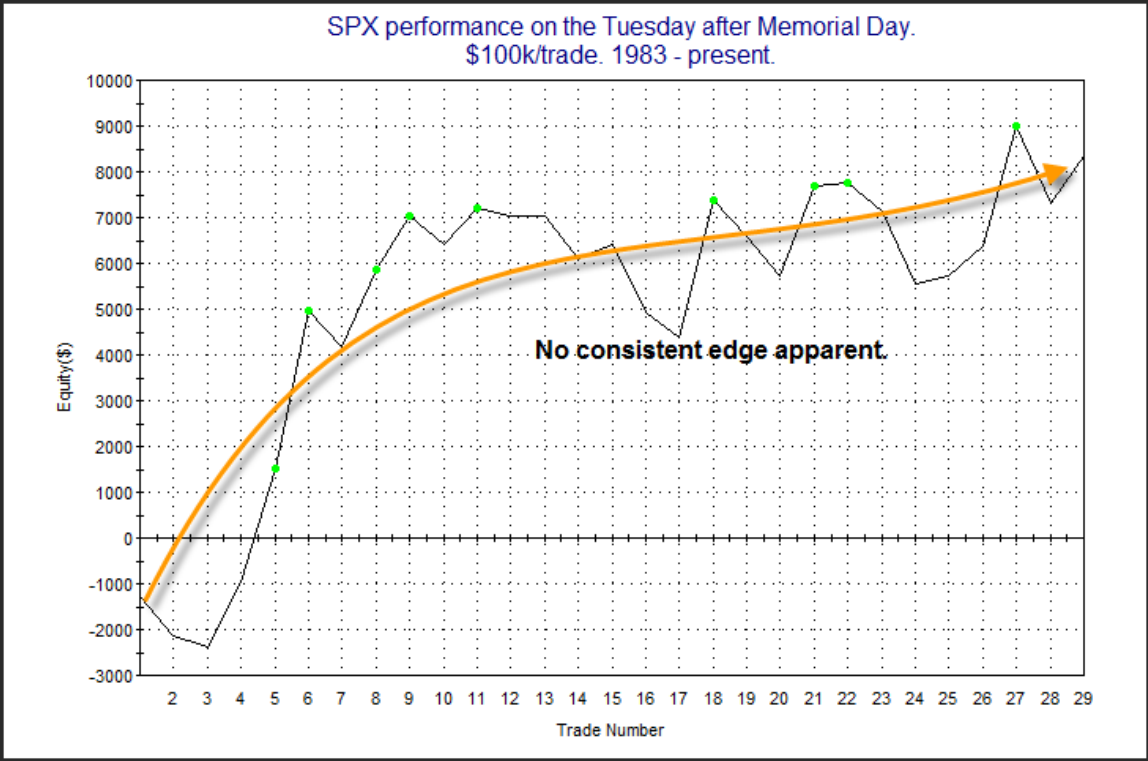
TradeStation Performance Summary Collapse ↕			
All Trades			
Total Net Profit	\$30,834.72	Profit Factor	3.84
Gross Profit	\$41,697.05	Gross Loss	(\$10,862.33)
Total Number of Trades	29	Percent Profitable	68.97%
Winning Trades	20	Losing Trades	9
Even Trades	0		
Avg. Trade Net Profit	\$1,063.27	Ratio Avg. Win:Avg. Loss	1.73
Avg. Winning Trade	\$2,084.85	Avg. Losing Trade	(\$1,206.93)
Largest Winning Trade	\$7,145.28	Largest Losing Trade	(\$2,320.50)

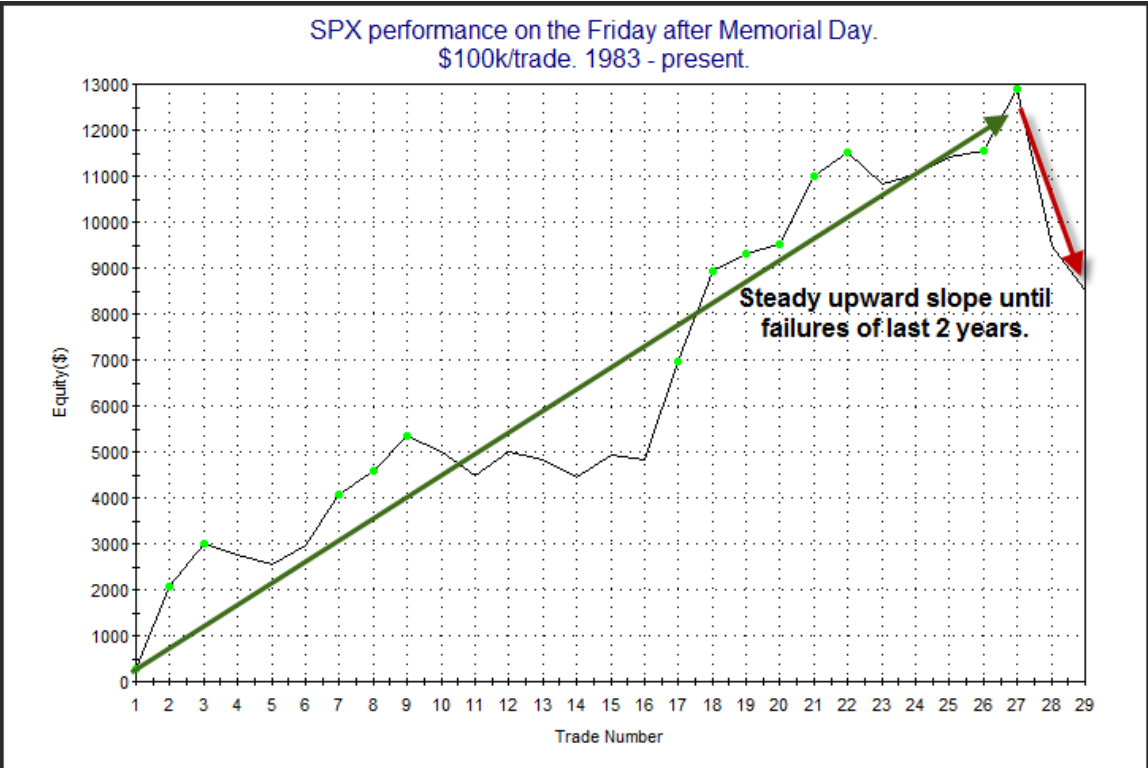
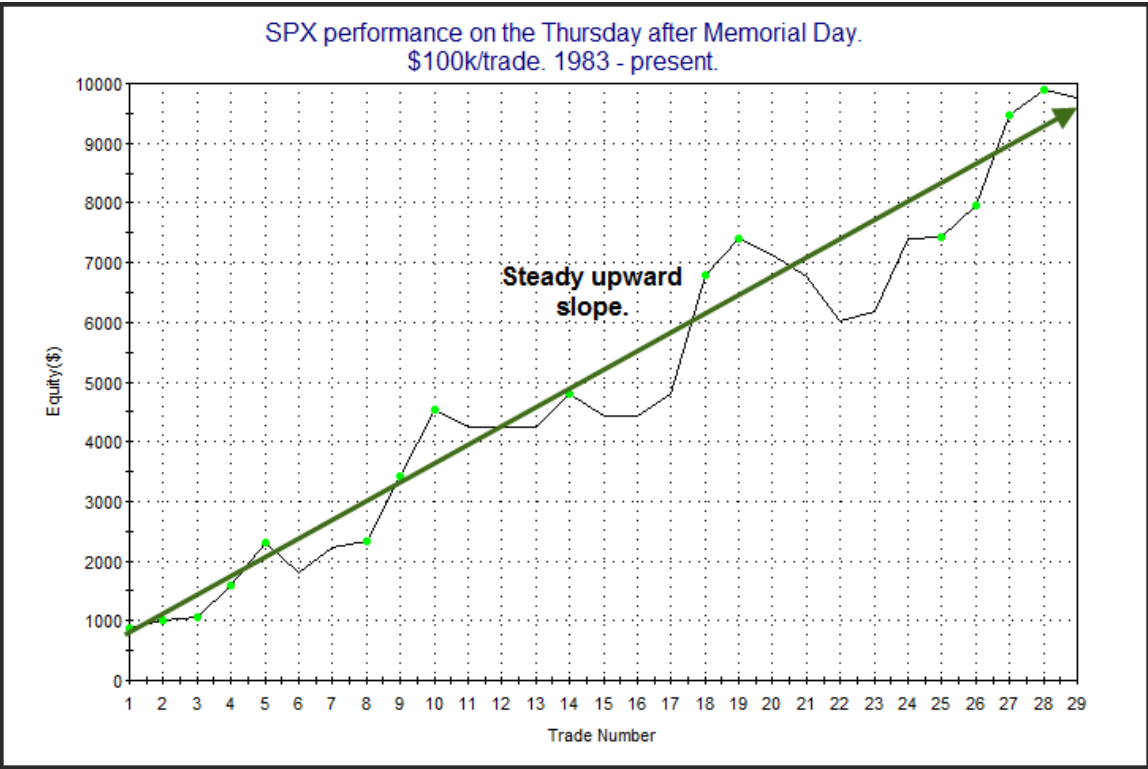
While the last 2 years were down the circled stats are all impressive. An average gain of nearly 1.1% for the 4-day period along with a profit factor of nearly 4 is very good, and at least worth further examination. Below is the same '83 – present time frame. Returns are broken down by the day of the week.

**SPX performance on X day of Memorial Day week.
\$100k/trade. 1983 - present.**

X Day	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
Fri	8,515.22	29	19	10	65.52	821.91	2,140.16	-710.12	-3,415.50	1.16	2.20	293.63
Thurs	9,764.39	29	21	7	72.41	592.72	1,970.50	-383.26	-735.68	1.55	4.64	336.70
Wed	4,113.48	29	20	9	68.97	589.14	2,573.31	-852.14	-2,268.10	0.69	1.54	141.84
Tues	8,358.52	29	14	15	48.28	1,487.53	3,443.56	-831.13	-1,701.70	1.79	1.67	288.22

The results table suggests Thursday is the most bullish day while Tuesday and Wednesday have seen the least gains and worst win %. So let's see how the edge has played out over time based on day of the week. The four equity curves below assume ownership on that particular day.





The charts seem to confirm what the results table was suggesting. Thursday appears to have the strongest bullish seasonality. Friday also appears to contain an upside edge. Tuesday and Wednesday have been a bit of a crapshoot.

Last year I also looked at the combination of Memorial week and the positive seasonality experienced on the 1st day of the month. I found that since 1977 any time you could buy the close of May 31st and sell the close of June 1st, then June 1 would have been a winner – until last year. I've updated below the results table.

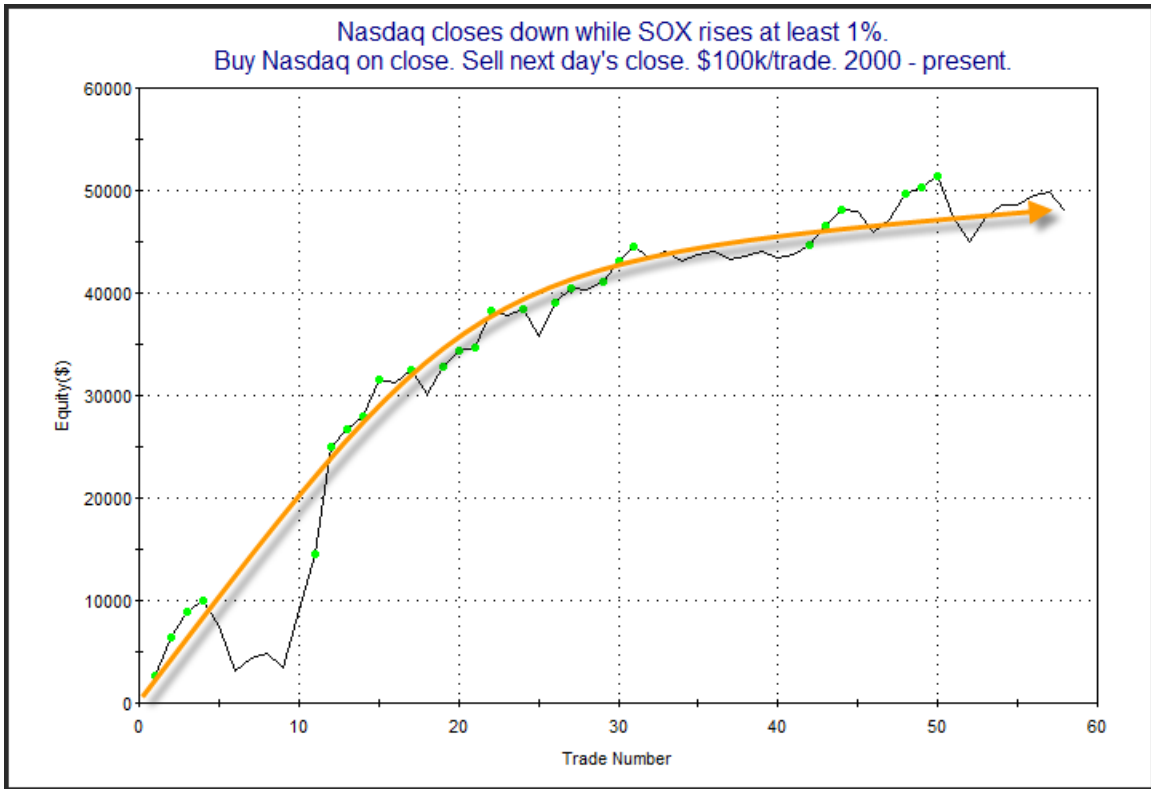
SPX performance on June 1 when it falls on Wed, Thurs, or Fri. after Memorial Day. \$100k/trade. 1977 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
05/31/77	Buy	\$96.12	0.84%	\$842.40
06/01/77	Sell	\$96.93		\$0.00
05/31/78	Buy	\$97.24	0.11%	\$719.60
06/01/78	Sell	\$97.35		(\$627.08)
05/31/79	Buy	\$99.08	0.08%	\$615.49
06/01/79	Sell	\$99.16		(\$514.59)
05/31/83	Buy	\$162.38	0.10%	\$750.30
06/01/83	Sell	\$162.55		(\$1,107.00)
05/31/84	Buy	\$150.55	1.79%	\$1,786.16
06/01/84	Sell	\$153.24		\$0.00
05/31/88	Buy	\$262.15	1.73%	\$2,007.87
06/01/88	Sell	\$266.68		(\$19.05)
05/31/89	Buy	\$320.52	0.45%	\$637.55
06/01/89	Sell	\$321.96		(\$158.61)
05/31/90	Buy	\$361.22	0.53%	\$634.80
06/01/90	Sell	\$363.15		(\$5.52)
05/31/94	Buy	\$456.51	0.25%	\$389.82
06/01/94	Sell	\$457.63		(\$551.88)
05/31/95	Buy	\$533.41	0.01%	\$149.60
06/01/95	Sell	\$533.49		(\$628.32)
05/31/00	Buy	\$1,420.65	1.98%	\$1,970.50
06/01/00	Sell	\$1,448.80		(\$3.50)
05/31/01	Buy	\$1,255.84	0.38%	\$750.50
06/01/01	Sell	\$1,260.67		(\$707.84)
05/31/05	Buy	\$1,191.52	0.90%	\$1,171.96
06/01/05	Sell	\$1,202.27		(\$40.67)
05/31/06	Buy	\$1,270.09	1.23%	\$1,218.36
06/01/06	Sell	\$1,285.71		(\$70.20)
05/31/07	Buy	\$1,530.62	0.37%	\$646.10
06/01/07	Sell	\$1,536.34		\$0.00
05/31/11	Buy	\$1,345.20	(2.28%)	\$0.00
06/01/11	Sell	\$1,314.55		(\$2,330.26)

A few thoughts: 1) Last year was a stark reminder that seasonal tendencies are not impervious to strong moves in the opposite direction. 2) Between 1962 and 1976 the SPX was only 2-3 under the above conditions. 3) The Memorial week edge didn't kick in until 1983 and the 1st of the month edge began in the late 80s. Therefore, the 5 instances between '77 and '84 may be due more to chance than to a seasonal influence. In any case, Friday would seem to carry some seasonal strength.

Another study I found worth reviewing was from the 12/8/11 subscriber letter. It looked at times where the NASDAQ composite declined while the SOX rose at least 1%. I have updated all the stats below.

TradeStation Performance Summary Collapse ▲			
All Trades			
Total Net Profit	\$47,965.98	Profit Factor	2.68
Gross Profit	\$76,508.82	Gross Loss	(\$28,542.84)
Total Number of Trades	58	Percent Profitable	70.69%
Winning Trades	41	Losing Trades	17
Even Trades	0		
Avg. Trade Net Profit	\$827.00	Ratio Avg. Win:Avg. Loss	1.11
Avg. Winning Trade	\$1,866.07	Avg. Losing Trade	(\$1,678.99)
Largest Winning Trade	\$10,390.72	Largest Losing Trade	(\$4,353.48)

Results here seem to suggest a 1-day upside edge for the Nasdaq. The “% Profitable”, “Profit Factor” and “Avg Trade” are all impressive. Below is a profit curve.



There appears to be some flattening in the curve as some of the biggest winners appeared early on. Still, the slope remains generally up and the study seems to be worth consideration.

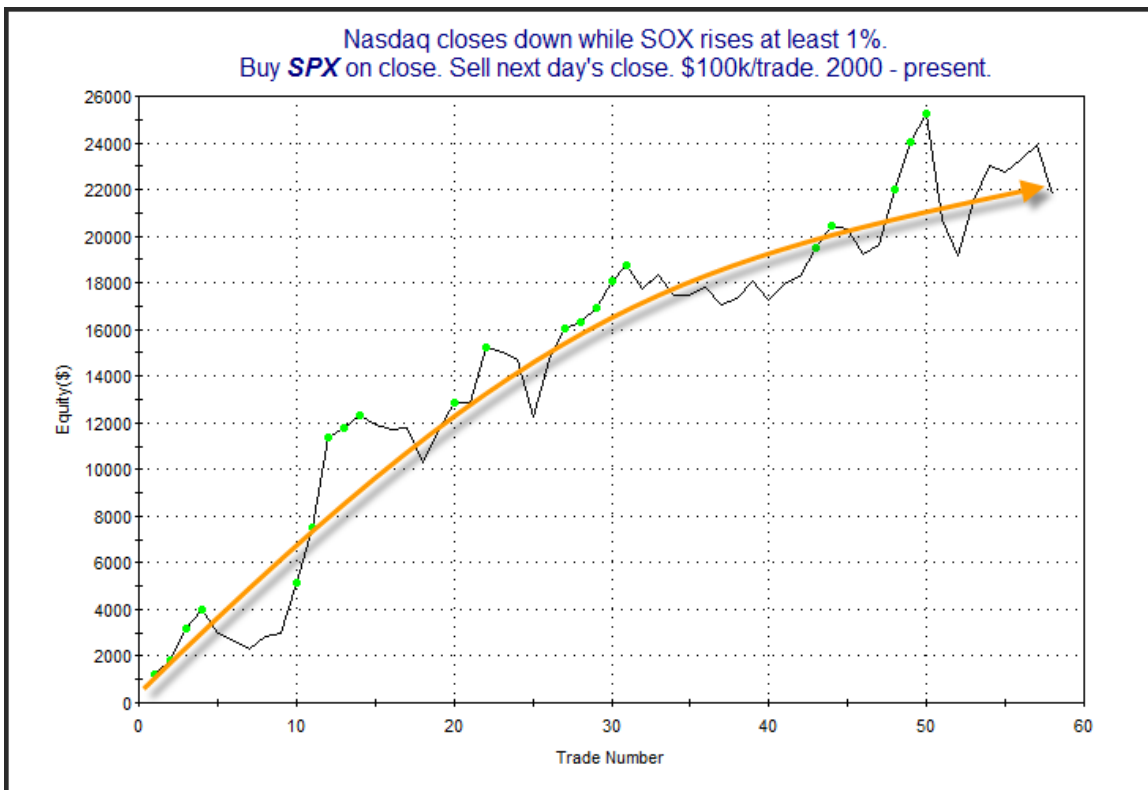
Of course the Aggregator anticipates SPX movement not Nasdaq movement, though the two are highly correlated. I decided to see how the SPX has performed when the setup triggered.

Nasdaq closes down while SOX rises at least 1%.
Buy **SPX** on close. Sell next day's close. \$100k/trade. 2000 - present.

TradeStation Performance Summary		Collapse ^	
All Trades			
Total Net Profit	\$21,817.68	Profit Factor	2.09
Gross Profit	\$41,838.93	Gross Loss	(\$20,021.25)
Total Number of Trades	58	Percent Profitable	65.52%
Winning Trades	38	Losing Trades	20
Even Trades	0		
Avg. Trade Net Profit	\$376.17	Ratio Avg. Win:Avg. Loss	1.10
Avg. Winning Trade	\$1,101.02	Avg. Losing Trade	(\$1,001.06)
Largest Winning Trade	\$3,863.25	Largest Losing Trade	(\$4,520.40)

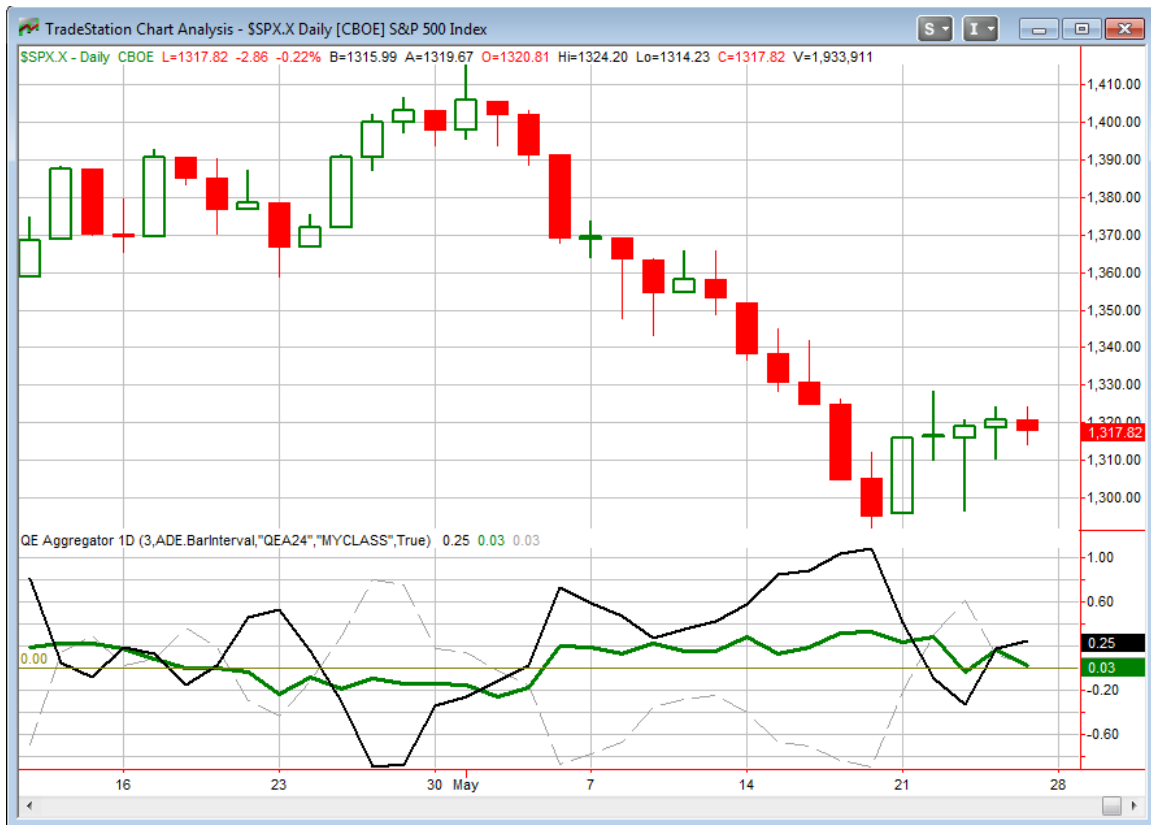
Based on these results it appears the SPX has benefitted as well. The strength of the upside edge isn't quite as strong though. The average instance sees a rise of about 0.4% instead of the 0.8% shown in the Nasdaq results. Traders looking to take advantage of the setup could consider trading the Nasdaq rather than the S&P in cases like this.

I also ran the SPX profit curve and have included it below.



The curve here appears similar to the Nasdaq profit curve without as much flattening.

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



Tonight saw the green Aggregator line dip but still hold positive. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line stayed above 0. 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 reflected on the systems page before the bell.

Based on the current studies, expectations will likely remain positive on Tuesday. This could change if bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,325.08 on Tuesday. This is 0.6% above Friday's close. So the SPX would need to close up at least this much in order to turn the differential line back negative.

Overall, I believe there is a mild upside bias at the moment. I'm carrying a small index position to try and take advantage of this upside edge. I'm not looking to increase my position just yet. While short-term bullish evidence is currently stronger than bearish evidence, it isn't overwhelming. Also, the QE Buying Power Index is slated to close at a bearish 0 on Tuesday. The 5-day net POMO flows at that point will be squarely negative, and as I have discussed numerous times, this is a situation where bullish inclinations have not paid off over the last few years. So I will continue to hold my small position and evaluate the edges that emerge over the next few days.

Intermediate-term Outlook (2 weeks – 2 months)– updated 5/29 – slightly bullish

The market bounced back a bit this week, with Friday being the only down day for the SPX. It is now in the early stages of attempting to end its slide and mount a new rally. So far all we have to go on is a short term bounce, which really isn't providing any evidence yet.

One thing I am on the lookout for now is an IBD Follow-Through Day (FTD). I have written an awful lot about FTDs on the blog over the years. Intermediate and short-term implications of FTDs are dependent on many different factors. A link to the FTD studies on the blog can be found below. If we get one in the next several days I will be sure to examine it closely and evaluate how it stands up historically.

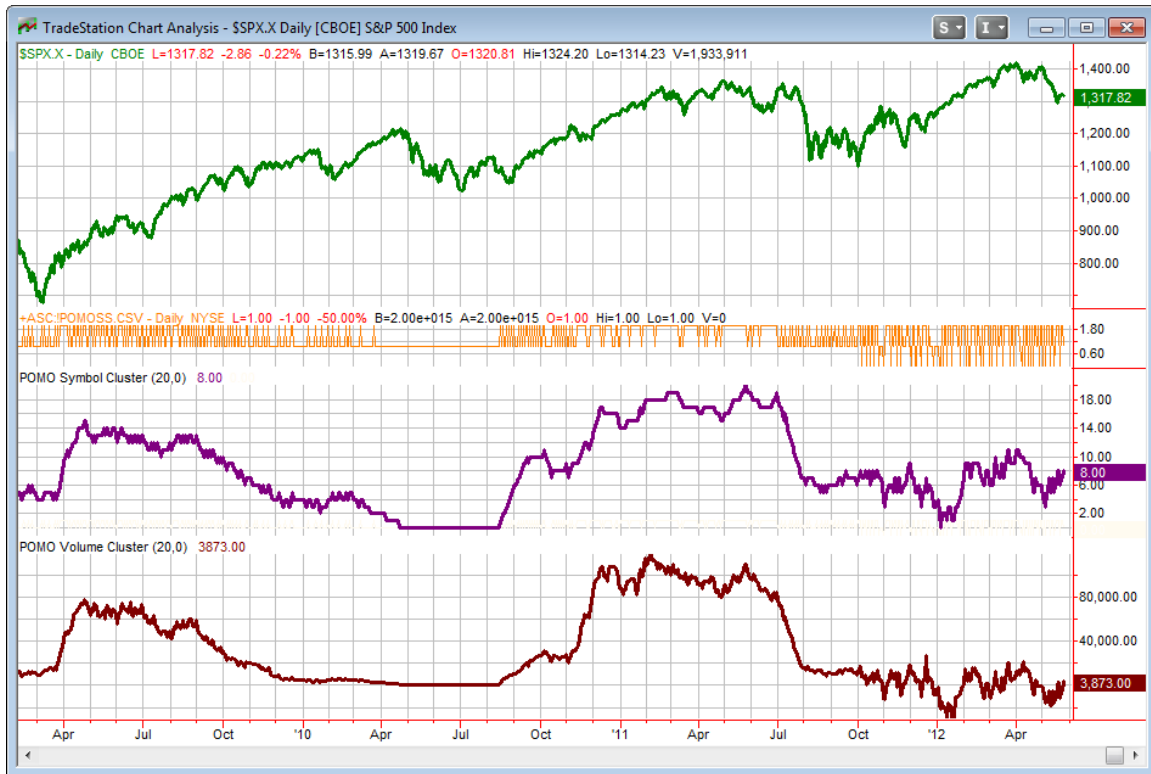
<http://quantifiableedges.blogspot.com/search/label/IBD%20Follow%20Through%20Day>

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 3 days of POMO buying and 1 day of selling this past week. The net result was about a \$1.5 billion liquidity injection. The intermediate-term POMO indicators remained around the modest levels that we saw last week. Liquidity measures have been modest at best since the market topped out in early April.

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 weak since early April the stock market has struggled.

This upcoming week will be very interesting. The Fed is scheduled to sell on Tuesday, before buying on Wednesday and Thursday. But the interesting action will occur on Thursday afternoon when the June POMO schedule is released. I will be sure to update

the QE Buying Power Index chart on the website on Thursday evening and discuss the formation next weekend. To access the chart at any time you may use the link below:

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

Intermediate-term evidence remains mixed. If we get a FTD sometime this week we will likely be able to use that to better forecast the intermediate-term outlook. I am maintaining a slightly bullish outlook this week, since the bulk of the active intermediate-term studies are bullish. POMO and FTD news this upcoming week could easily swing my outlook in either direction.

Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

Open Catapult Triggers

JPM – 1/3 @ \$32.51 (not filled and not currently looking for a fill)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 1 (JPM)

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
QQQ(1/4)	5/7/2012	\$64.31	\$62.07	-3.48%		Aggregator

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