

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 25, 2012

Volume 5 Issue 121

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- Friday's bounce after Thursday's big drop came right in the "sweet spot" of where you would like to see a bounce perform.
- Unfilled gaps up that fail to make a higher high will often pull back over the next few days.

## Short-term Outlook

### The Bottom Line

The Aggregator is still bullish and the bounce looks good so far. The unfilled gap up on Friday left me without a fill on my long entry attempt. There still appears to be room to run to the upside, but I am going to be out of the office and will be sitting out a day.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
June 25, 2012	SPY unfill gap up. Lower high. > 200ma	1-3 days	Bearish	-1.50%
June 25, 2012	Sweet spot bounce from 1.75% drop	1-5 days	Bullish	3.00%
June 22, 2012	SPY closes at 5-day low 1st time > 2 wks	1-4 days	Bullish	1.60%
<b>Active - Long Term</b>				
June 25, 2012	SPX/Nas RS shows Nasdaq leading	int term	Bullish	
June 18, 2012	POMO modestly bullish	int term	slight bull	
June 13, 2012	FTD with modest breadth & vol	int term	Bearish	
June 7, 2012	90% up day on 3rd day of rally	1-14 days	Bullish	
February 1, 2012	Golden Cross	int term	Bullish	
<b>Dropped Tonight</b>				
<b>June 12, 2012</b>	<b>SPY 3high, 3low, 3low close.</b>	<b>1-10 days</b>	<b>Bullish</b>	<b>3.30%</b>
June 19, 2012	SPY low vol 20, high price 10.	1-4 days	Bearish	
June 18, 2012	SPX up 1%-2% opex week	1-5 days	Bearish	-1.40%

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

***The Evidence***

After a big drop on Thursday the market reacted with a fairly strong bounce-back day Friday. The SPX rallied 0.7%, the Nasdaq gained 1.2%, and the Russell 2000 rose 1.4%. Breadth was solidly positive as the NYSE Up Issues % came in at 75% and the Up Volume % was 68%. Total NYSE volume ran light for most of the day but had a massive spike in the last minute or so thanks to the Russell rebalancing.

Often after a sharp decline we are able to get nice clues about the bounce simply by examining how it begins. After a sizable drop, if the market puts in a very weak bounce that makes up for less than ¼ of the previous day's large loss, then that is often a bad sign. Stronger initial bounces like we saw Friday tend to fare much better. In the 3/14/11 Subscriber Letter I broke down the following days' performance based on the relative size of the day one bounce. Let's review those findings.

This first table below shows results for very weak bounces. It was last updated on 4/29/10, so I did update it tonight.

SPX falls at least 1.75% yesterday. Today it rises but it makes up less than 25% of yesterday's loss. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1988 - 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
10	-8,503.52	26	11	15	42.31	2,883.27	6,309.90	-2,681.30	-5,842.90	1.08	0.79	-327.06
9	-10,512.49	28	13	15	46.43	2,251.84	4,807.00	-2,652.43	-4,452.66	0.85	0.74	-375.45
8	-8,925.66	29	13	16	44.83	2,184.67	4,664.22	-2,332.90	-5,166.06	0.94	0.76	-307.78
7	-7,491.63	29	13	16	44.83	2,338.91	5,284.85	-2,368.59	-6,002.13	0.99	0.80	-258.33
6	-15,303.36	29	12	17	41.38	1,767.03	4,762.35	-2,147.51	-5,473.17	0.82	0.58	-527.70
5	-17,542.01	29	11	18	37.93	1,619.47	4,769.00	-1,964.23	-5,506.23	0.82	0.50	-604.90
4	-21,526.70	29	10	19	34.48	1,650.54	2,587.95	-2,001.69	-4,284.75	0.82	0.43	-742.30
3	-25,404.78	29	8	21	27.59	1,561.43	3,939.79	-1,804.58	-5,685.45	0.87	0.33	-876.03
2	-18,801.39	30	13	17	43.33	662.39	2,794.56	-1,612.50	-3,844.10	0.41	0.31	-626.71
1	-13,456.63	30	11	19	36.67	587.50	1,669.20	-1,048.38	-2,302.95	0.56	0.32	-448.55

As you can see these weak bounces don't often get very far before a new leg down ensues.

This next table examines very strong bounces after big drops. Results here have not changed since the 3/14/11 publication.

SPX falls at least 1.75% yesterday. Today it makes up more than 75% of yesterday's loss. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1988 - present.

X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	10,065.10	11	6	5	54.55	2,695.45	-1,221.52	2.21	2.65	915.01
9	18,347.76	12	7	5	58.33	3,222.39	-841.79	3.83	5.36	1,528.98
8	13,458.35	12	8	4	66.67	2,717.76	-2,070.94	1.31	2.62	1,121.53
7	20,267.80	13	7	6	53.85	3,881.73	-1,150.72	3.37	3.94	1,559.06
6	21,024.09	13	9	4	69.23	3,062.40	-1,634.39	1.87	4.22	1,617.24
5	20,983.30	13	9	4	69.23	2,686.85	-799.58	3.36	7.56	1,614.10
4	15,131.28	13	8	5	61.54	2,696.96	-1,288.88	2.09	3.35	1,163.94
3	11,326.45	13	7	6	53.85	2,398.77	-910.83	2.63	3.07	871.27
2	8,507.74	13	8	5	61.54	1,872.31	-1,294.15	1.45	2.31	654.44
1	993.58	13	6	7	46.15	1,473.27	-1,120.87	1.31	1.13	76.43

**12 of 13 instances closed above the entry price at some point in the next week. All of them did so within 6 days.**

Instances are a bit low here but the results are a sharp contrast to the results from the "weak-bounce" test.

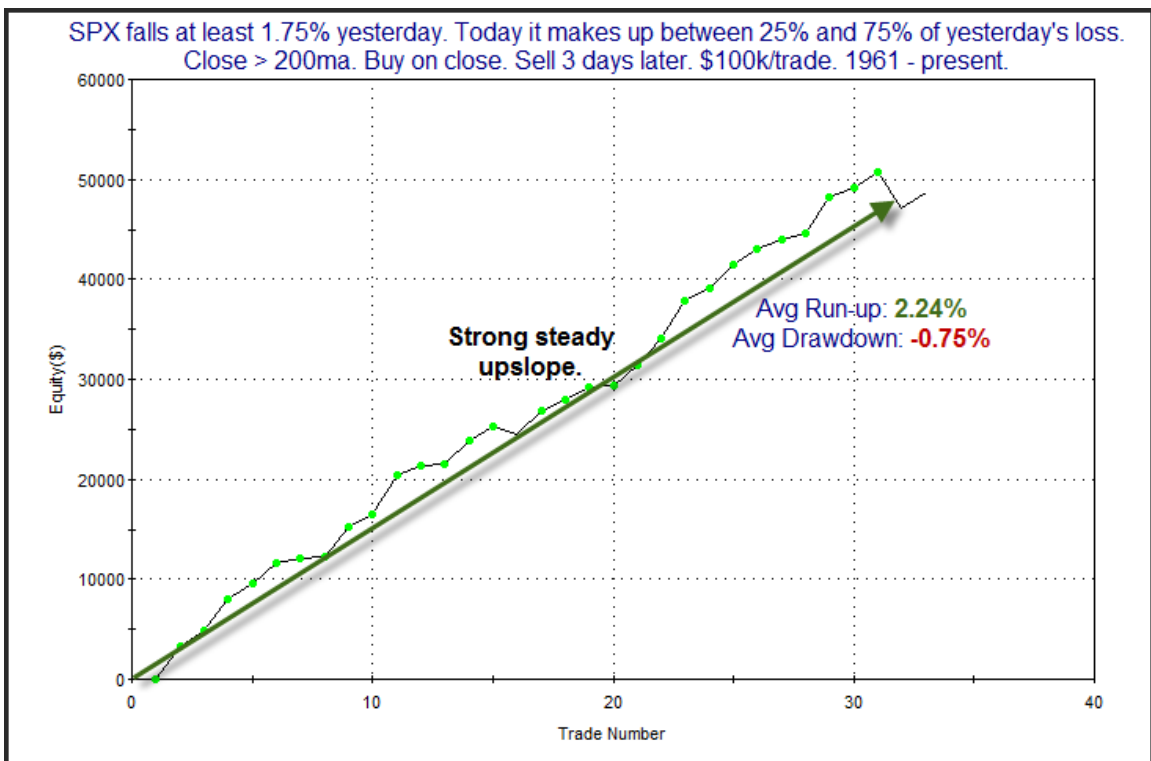
Previous findings revealed the real sweet spot for the day 1 bounce is right between these two. That is where we fell Friday and that study I also updated below. Though rather than just go back to 1988 as those others did, I went all the way back to 1961.

SPX falls at least 1.75% yesterday. Today it makes up between 25% and 75% of yesterday's loss.  
Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1961 - present.

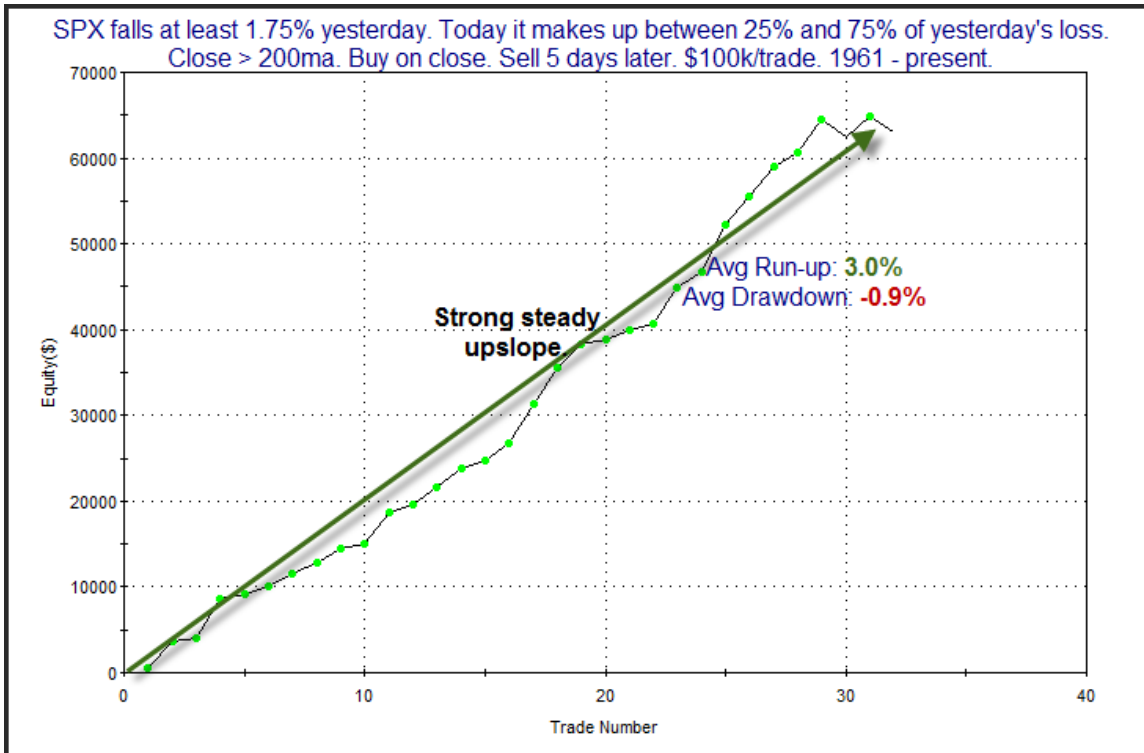
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	63,037.71	32	30	2	93.75	2,235.29	5,396.71	-2,010.49	-2,115.67	1.11	16.68	1,969.93
4	52,850.01	33	29	4	87.88	1,979.23	4,989.22	-1,136.89	-2,322.56	1.74	12.62	1,601.52
3	48,748.64	33	31	2	93.94	1,713.97	3,876.62	-2,192.16	-3,602.40	0.78	12.12	1,477.23
2	34,131.85	33	23	10	69.70	1,845.67	4,001.40	-831.85	-2,136.90	2.22	5.10	1,034.30
1	27,894.77	33	25	8	75.76	1,219.05	2,937.71	-322.69	-599.64	3.78	11.81	845.30

**The only instance that failed to close above the entry price at some point in the next 4 days was the one that triggered on 3/11/11.**

Study results don't often get more lopsided than this. Implications over the next week appear to be strongly bullish. Below I have posted the 3-day and 5-day equity curves. First I'll show the 3-day:



Not only have the results been extremely consistent, but the stats shown indicate risk/reward has strongly favored the bulls. Now here are results using a 5-day exit.



Here again we see a consistent upslope and risk/reward heavily favoring the bulls.

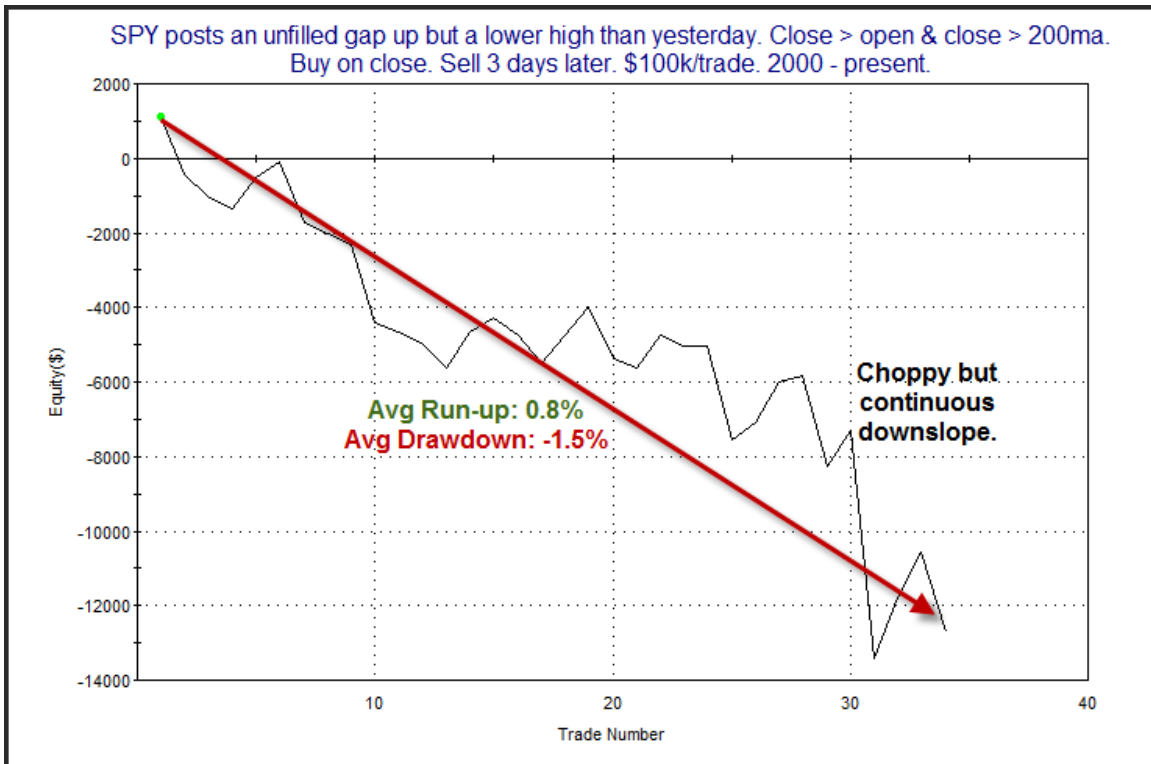
Not all the indications were positive though. In the 12/30/11 letter I looked at inside days like Friday where the market gapped higher, never filled, and moved higher from open to close without making a higher high. I've updated those results below.

SPY posts an unfilled gap up but a lower high than yesterday. Close > open & close > 200ma.  
Buy on close. Sell X days later. \$100k/trade. 2000 - 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
10	-7,991.21	30	14	16	46.67	1,816.65	3,743.30	-2,089.02	-5,312.00	0.87	0.76	-266.37
9	-10,919.71	30	12	18	40.00	1,843.55	3,442.11	-1,835.68	-5,361.80	1.00	0.67	-363.99
8	-8,313.91	31	14	17	45.16	1,732.35	3,111.90	-1,915.70	-5,654.80	0.90	0.74	-268.19
7	-7,633.41	32	14	18	43.75	1,846.74	3,093.86	-1,860.43	-9,172.30	0.99	0.77	-238.54
6	-13,145.64	33	15	18	45.45	1,268.41	3,022.53	-1,787.32	-3,751.60	0.71	0.59	-398.35
5	-11,970.93	33	13	20	39.39	1,310.06	2,556.33	-1,450.09	-3,477.70	0.90	0.59	-362.76
4	-11,268.38	33	15	18	45.45	1,108.46	1,919.19	-1,549.74	-7,544.70	0.72	0.60	-341.47
3	-12,712.05	34	15	19	44.12	775.91	1,631.70	-1,281.62	-6,150.30	0.61	0.48	-373.88
2	-10,288.32	35	12	23	34.29	860.34	1,657.26	-896.19	-2,929.90	0.96	0.50	-293.95
1	-7,931.41	35	12	23	34.29	704.94	1,600.62	-712.64	-2,348.90	0.99	0.52	-226.61

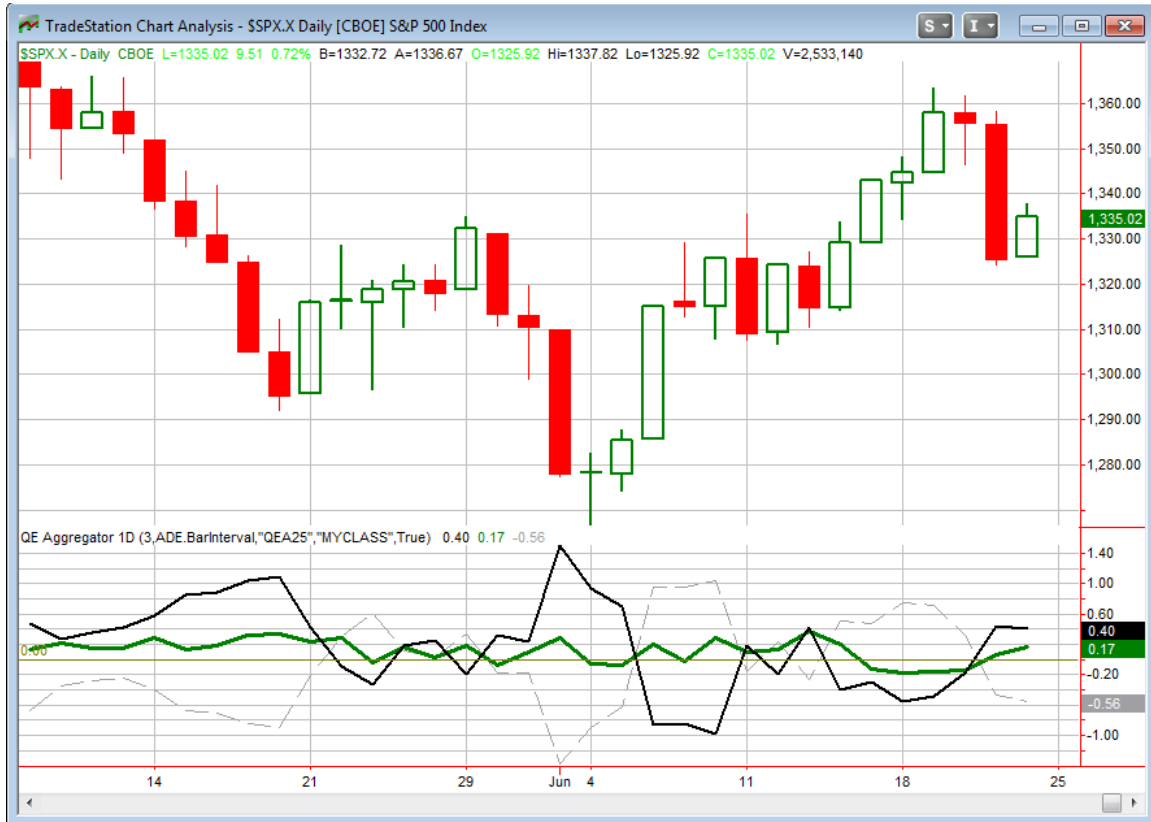
**31 of 35 instances (89%) closed below the entry price at some point in the next week.**

Implications here appear somewhat bearish, with most of the damage occurring within the 1<sup>st</sup> 3 days. Below is a profit curve that shows how the downside edge has played out over time.



This is not an ideal profit curve but it still appears to suggest a downside edge.

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



Tonight's studies caused the green Aggregator line to move even more positive. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line also held firm 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 before the bell.

Based on the current active studies expectations are set to remain positive Monday. Of course this could change if more bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,348.88 on Friday. A close at or above this level would cause the Differential Line to flip back below 0, indicating the SPX has moved from oversold to overbought. It would require a gain of just over 1% to get there.

In Thursday night's subscriber letter I put out a trade idea to buy some SPY. Unfortunately, with Friday's unfilled gap, the trade idea never received a fill since I used a limit order equal to Thursday's close. A long-time subscriber sent me a note asking if this was becoming more common, since there have been a few trade ideas like this recently that went unfilled. I found it an interesting question and looked back over the last 4.5 years. Since 2008 there have been between 24-36 instances each year – or an average of 2-3 per month. The most were in 2009 and the least in 2010. So far in 2012 we are running a little above that pace since there have now been 20 such occurrences. Interestingly, they have all been on the long side this year – which is unheard of. I've always felt the market was inclined to begin its reversions in the overnight session. This is why I publish the "likely" Aggregator signal on the systems page prior to the closing bell for gold subscribers. I often will take part of my personal positions near the close, and then the rest the next day after the Aggregator signal has been confirmed by my nightly research. Aggressive traders with gold subscriptions may want to consider utilizing the information provided by the Intraday Quantifinder and on the Systems page each day as we near the close.

While the trade idea did not fill on Friday, there still appears to be an upside edge over the next few days. I am not going to be in the office on Monday. Under normal circumstances I might place a limit order a bit below Friday's close to see if I could catch an intraday dip. More aggressive traders could look for entry even higher. I'm going to be very conservative and just sit it out for a day. I simply don't want to have it on my mind on Monday when my market access may be limited.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 6/25 – slightly bullish***

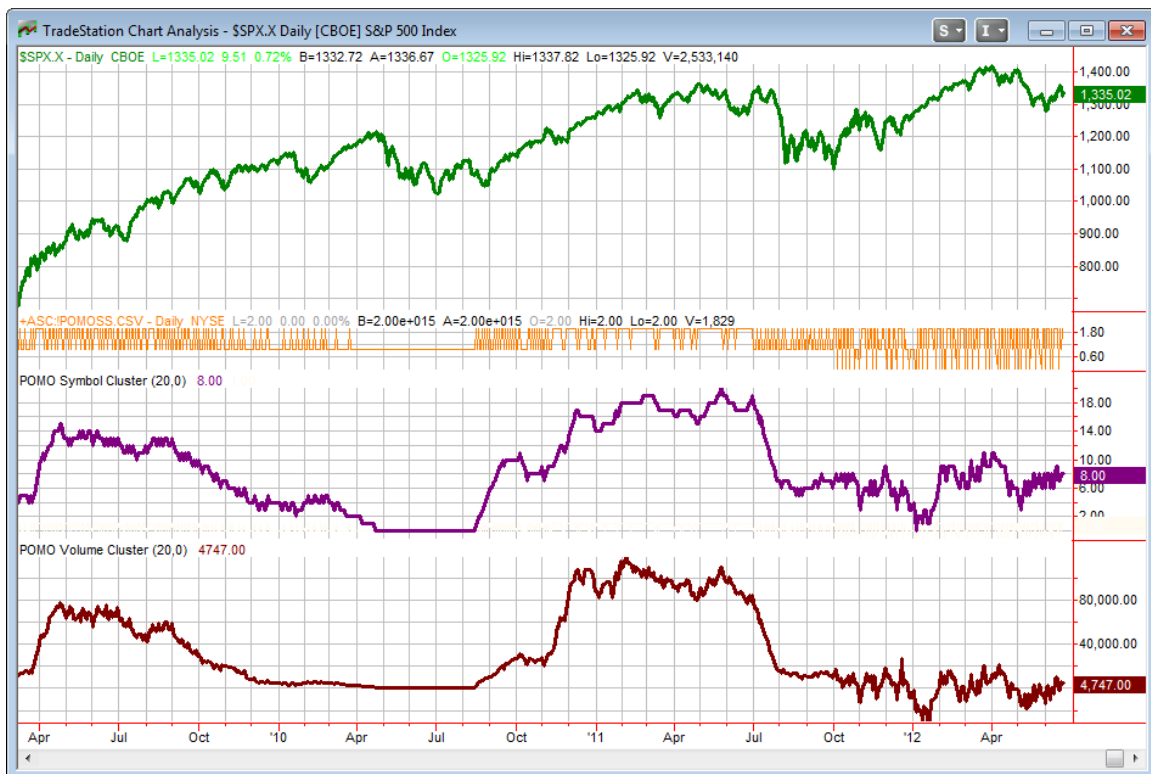
It was a back and forth week for the market, with the net result a small loss. The market is still struggling to establish an uptrend after bottoming nearly 3 weeks ago. We did get a little more confirmation of a burgeoning upmove.

One bit of good news this week is that the NASDAQ was able to regain its leadership position after lagging since the beginning of May. This is based on the SPX/NASDAQ Relative Strength Indicator that can be found on the charts page. Since the inception of the Nasdaq, the SPX has gained over 1,400 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 1 day of selling this past week. The net result was a moderate \$1.6 billion liquidity infusion. This dropped the intermediate-term POMO indicators, but they still remained positive and near the upper end of the range for the last 2 months.

This upcoming week is scheduled to see outflows of about \$5 billion. The Fed is set to sell on Monday and Thursday, and buy the other 3 days. While Operation Twist was scheduled to expire at the end of June, the Fed announced this past week that they will be continuing it for several more months. The current POMO schedule only goes through Friday. The new one for July will be released on Friday afternoon. I will be sure to discuss it next weekend.

Intermediate-term evidence remains mixed but there appears to be a slight bullish tilt. Bullish evidence comes from POMO flows, momentum, and relative strength studies. FTD inclinations initially appeared bearish but the fact that the market has continued to move higher since the FTD is encouraging. I am still moderately favoring the bull case, but not yet ready to get aggressive.

### **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**

*None.*

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