

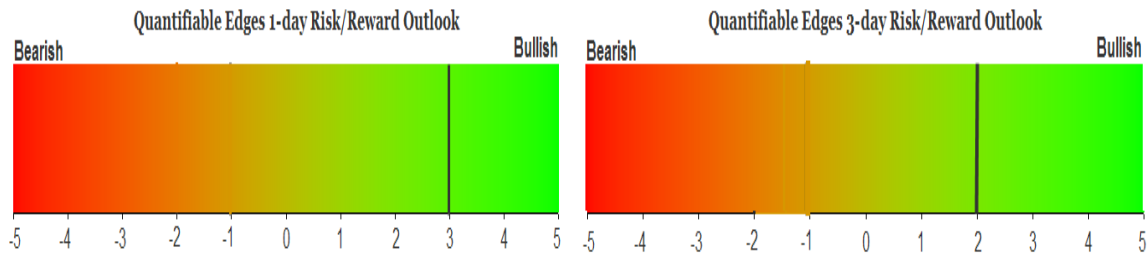
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 19, 2011

Volume 4 Issue 244

Market Overview



Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Long	100% Long XIV	100% Long XIV	Flat

Tonight's Research Points

- The next period of seasonal strength begins at the close on Wednesday.

Short-term Outlook

The Bottom Line

The Aggregator is still suggesting an upside edge. I have a fair amount of long exposure in anticipation of further gains. I will be looking to exit some on Monday unless we get a weak start to the day that fails to bounce.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
December 15, 2011	3-day drop < 200ma > 20low. HV low	1-3 days	Bullish	3.00%
Active - Long Term				
December 12, 2011	Seasonal strength into year end	thru 1/2	Bullish	
December 5, 2011	POMO scheduled to turn negative	int term	Bearish	
December 5, 2011	3 20-day VIX lows. No SPY 20-high	1-20 days	Bearish	-7.30%
December 1, 2011	90% up day on at least 3rd day higher	1-14 days	Bullish	
November 18, 2011	Triangle breakdown	int term	Bullish	
October 30, 2011	SPX & bond yields hit 50-day highs	1-50 days	Bearish	
October 19, 2011	50-day high on 90% up vol	1-50 days	Bullish	
October 19, 2011	FTD on strong breadth/20day high	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

For the 2nd day in a row we saw a strong start that faded and finished with just mild gains. The major indices were mixed with the Dow finishing lower. The SPX closed up 0.3%, the Nasdaq gained 0.6%, and the Russell 2000 rose 0.9%. Breadth was tilted positive as the NYSE Up Issues % came in at 62% and the Up Volume % was 64%. Total NYSE volume rose with options expiration providing some help.

The bounce over the last 2 days has been very odd. I tried looking for other instances since 1990 where the SPX was below its 200ma, made a 10-day low and the rose the next 2 days, but closed in the bottom 1/3 of its intraday range both days. I found no other instances. I loosened the requirement to the bottom 1/2 of the range. Still nothing. I looked for 2 up closes in the bottom 1/3 and eliminated the need for a 10-day closing low. Still nothing. The bottom line appears to be that current action is quite unusual. There aren't any precedents to go by and that is making it difficult to forecast the short-term. For the 1st time in a while the Quantifinder also came up completely blank.

While the intermediate-term looks somewhat positive the short-term is dicey. There is still 1 short-term study listed and it is bullish. Between that and the positive intermediate-term outlook the Aggregator is giving an edge to the bulls. But things could change quickly here as action unfolds in the next few days.

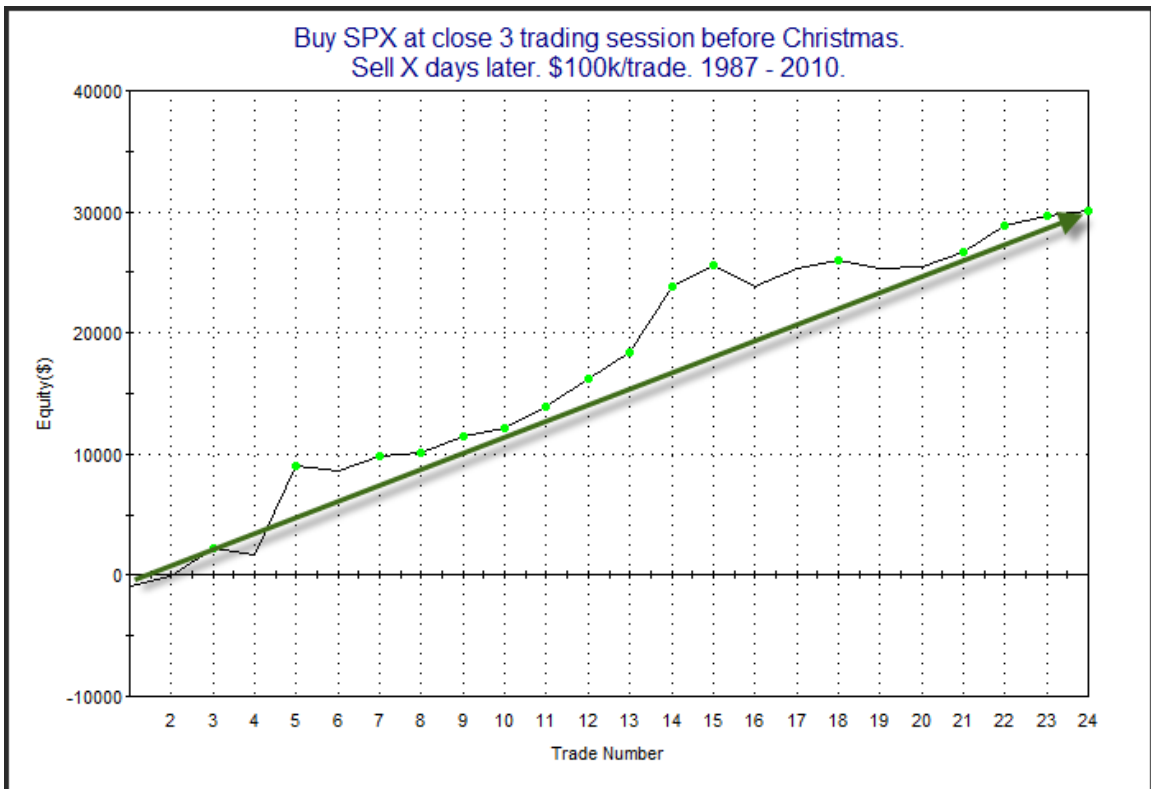
For the SPX, the next seasonally strong period will begin on Wednesday's close. The study below is the "Twas 3 Nights Before Christmas" study, and I have shown it each year in the letter. Results are updated.

Buy SPX at close 3 trading session before Christmas.
Sell X days later. \$100k/trade. 1987 - 2010.

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	32,050.13	24	18	6	75.00	2,574.50	7,830.30	-2,381.80	-4,436.38	1.08	3.24	1,335.42
9	39,156.29	24	17	7	70.83	3,025.01	7,974.78	-1,752.70	-3,298.00	1.73	4.19	1,631.51
8	44,918.00	24	18	6	75.00	2,799.30	8,333.40	-911.57	-2,482.44	3.07	9.21	1,871.58
7	33,552.19	24	17	7	70.83	2,328.41	7,796.76	-861.54	-1,580.04	2.70	6.56	1,398.01
6	24,388.26	24	16	8	66.67	1,954.63	7,752.90	-860.73	-1,768.23	2.27	4.54	1,016.18
5	30,019.28	24	19	5	79.17	1,794.38	7,247.22	-814.81	-1,815.96	2.20	8.37	1,250.80
4	20,398.67	24	16	8	66.67	1,665.18	5,070.22	-780.52	-2,258.85	2.13	4.27	849.94
3	16,650.66	24	16	8	66.67	1,395.57	4,592.40	-709.80	-1,794.00	1.97	3.93	693.78
2	15,000.67	24	18	6	75.00	1,057.36	3,257.17	-671.96	-2,185.04	1.57	4.72	625.03
1	9,411.39	24	18	6	75.00	721.70	2,523.24	-596.55	-1,518.40	1.21	3.63	392.14

23 of 24 instances (96%) closed above the entry price at some point in the next 5 trading days.

The stats all appear quite strong. I would note the “Max Losing Trade” column shows very mild numbers from days 1-8, with no decline being worse than 2.5%. Below is a profit curve using a 5-day holding period.



The strong, steady upslope seems to confirm the bullish tendency. Of course this won't kick in until Wednesday's close, but I thought it was worth a reminder before we get there.

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



The green Aggregator Line remained solidly positive. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line is also still above 0. A positive Differential reading means the SPX has underperformed expectations over the last few days. So net expectations are bullish and the SPX is somewhat oversold versus recent expectations. Historically, this setup has provided an upside edge. It can be seen on the chart whenever both lines close above zero. This caused the Aggregator System to remain long at the close. This was indicated on the Systems page shortly before the bell.

Our last remaining short-term study is expiring on Monday. If anything fails to emerge the intermediate-term studies will keep the expectations positive. This could easily change if new bearish evidence emerges. Studies that emerge over the next few days will

go a long way towards determining short-term expectations. The Differential Pivot will be mildly inverted at 1,216.33 on Monday. This is 0.3% *below* Friday's close. The inverted pivot means a flat close will cause the Differential Line to flip negative as the market would be considered overbought versus expectations. To avoid this, the SPX would need to close down at least 0.3%.

When a position is active and we have an inverted pivot, then it can often be a good idea to manage that trade a little more closely. We know any close above 1,216.33 will cause the Aggregator long signal to turn flat or short. Therefore, one approach I will often use in these situations in to trail a stop under any morning rally. Expecting to get out at the end of the day anyway, the trailing stop will allow me to lock in profits in case of a reversal and afternoon collapse. If the reversal goes all the way through the Differential Pivot then there is a chance the long signal would remain in place. In a case like this traders could consider re-entering at the close, which would be at a lower price than they sold earlier in the day.

As a quick summary, there still appears to be a mild upside edge. I have a long position and am looking to take advantage of a bounce. I am not looking to add more at this time, but I am aiming to take some profits here unless the market tanks early on and fails to rebound.

Intermediate-term Outlook (2 weeks – 2 months)– updated 12/19 – somewhat bullish

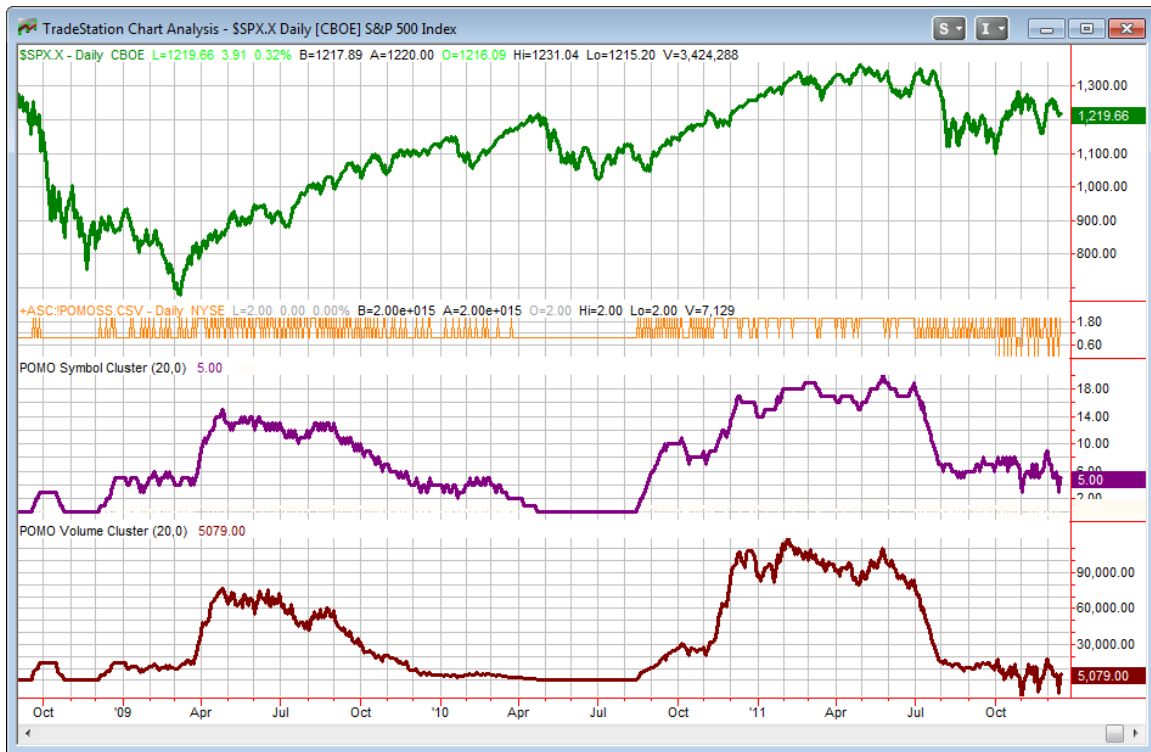
For only the 2nd time in the last 28 years the SPX failed to post a close during December op-ex week that was above the close of the previous week. Minimal damage was done, but it was still a little disconcerting to see the market fail to deliver during such a seasonally strong period. As I mentioned in the short-term outlook above, the next seasonally strong period is about to begin on Wednesday's close.

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>



This week the Fed added a net \$4.8 billion to the system with purchases a bit stronger than sales. The net volume over the last 20 days is now \$5.1 billion injected, which is in the middle of its recent range.

The bad news is that the December POMO schedule worsens in the next several weeks and outflows are expected.

The intermediate-term is somewhat mixed. The intermediate-term active studies list is showing a fair amount of both bullish and bearish indications. With seasonality strong over the next few weeks I am inclined to give a slight edge to the bulls. Of course this could change as things evolve this week.

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

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
XIV(1/2)	11/21/2011	\$4.91	\$6.04	23.01%	\$4.99	looking to hold a while
SPY(1/4)	12/14/2011	\$122.56	\$122.36	-0.16%		price adjusted for dividend
IWM(1/4)	12/15/2011	\$71.04	\$72.26	1.72%		Aggregator/Seasonal

I will look to sell my 1 lot of SPY on an SPX close > 1,216.33. If the morning low is above this level I will move a stop under the morning low after the first 30 minutes. Also, if the SPY gaps up and opens > \$122.50 then I will sell ½ my SPY at the open and look to trail a stop on the remaining. I may send out intraday updates if I adjust my stop or change this approach.

More detailed exit strategies for XIV and IWM may be found in the 12/16/11 Letter.

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