

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 23, 2011

Volume 4 Issue 248

Market Overview



Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Short	100% Short SPY	Flat	Flat

Tonight's Research Points

- 3 days higher in a long-term downtrend when not coming off an intermediate-term low has reliably led to a pullback over the last 10 years..

Short-term Outlook

The Bottom Line

The market is getting more stretched to the upside and short-term bearish evidence is building. I will look to take off my long QQQ tomorrow should the market rally further and continue to hold my short SPY.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
December 23, 2011	3 up < 200ma. No 50-low.	1-3 days	Bearish	-2.80%
December 22, 2011	Twas 3 nights before Christmas	1-5 days	Bullish	
December 22, 2011	Low VXO, no highSPY	1-4 days	Bearish	
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%
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

Seasonality won out on Thursday and the market put in solid gains once again. The SPX and Nasdaq each rose 0.8% while the Russell 2000 gained 0.7%. Breadth was strongly positive as the NYSE Up Issues % came in at 74% and the Up Volume % was 80%. Total NYSE volume was light, and it probably will continue to be light until January.

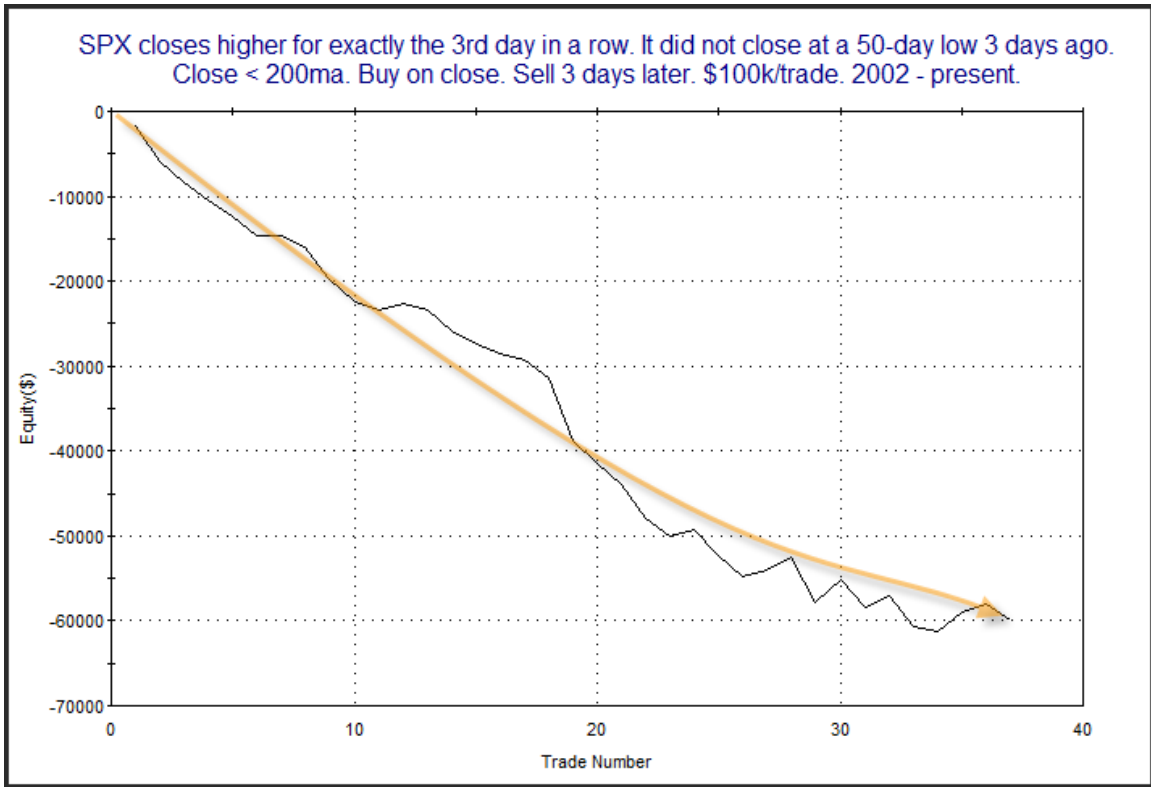
A lot more studies appeared tonight in the Quantifinder than last night, but there is really a lot less to talk about. Many of the studies noted the low volume (and suggested it was bearish). But while volume is low compared to the last few weeks, it is supposed to be low as we head into the holidays. So I will be ignoring all volume-related studies tonight and into the New Year.

There were still a few studies tonight related to the 3-day rally in the SPX. The one I chose to highlight below was last seen in the 10/25/11 letter. All stats are updated.

SPX closes higher for exactly the 3rd day in a row. It did not close at a 50-day low 3 days ago. Close < 200ma. Buy on close. Sell X days later. \$100k/trade. 2002 - 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	-49,017.41	34	13	21	38.24	1,487.94	3,468.36	-3,255.27	-9,202.08	0.46	0.28	-1,441.69
4	-58,375.10	37	13	24	35.14	1,307.39	2,966.88	-3,140.47	-7,499.80	0.42	0.23	-1,577.71
3	-60,001.51	37	8	29	21.62	1,368.68	2,728.32	-2,446.58	-7,527.12	0.56	0.15	-1,621.66
2	-32,344.99	37	7	30	18.92	1,001.01	2,295.72	-1,311.74	-4,121.10	0.76	0.18	-874.19
1	-21,513.60	37	13	24	35.14	1,035.92	3,348.84	-1,457.52	-4,871.22	0.71	0.38	-581.45

34 of 37 instances (92%) closed below the entry price at some point in the next week.

The statistics here appear strongly negative. The downside edge appears to max out around day 3, so I ran the profit curve below using that time frame.



While flattening out just a tad lately this equity curve still looks very appealing and serves as confirmation of the bearish tendencies.

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



With tonight's study factored in the green Aggregator line remained solidly negative. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the black Differential Line is now stretched far below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are bearish and the SPX is strongly overbought versus recent expectations. Historically, this setup has provided a downside edge. It can be seen on the chart whenever both lines close below zero. This caused the Aggregator System to remain short at the close. This was indicated on the Systems page shortly before the bell.

Based on the current active studies, expectations are set to remain negative for the next couple of days. Of course new evidence could emerge that would change this. The Differential Pivot will be 1,241.75 on Friday. This is about 1% below Thursday's close. So it would take a drop of at least this much in order to work off the current overbought condition and flip the Differential line to positive.

With both the Aggregator and Differential lines dropping lower tonight the outlook is a bit more short-term bearish than it was last night. Of course there is still the strong seasonality (and recent momentum) to contend with. From a technical standpoint, the SPX is closing in on its 200ma and December highs (1,260 – 1,266 area), which could act as resistance. Above that the November and October highs are in the 1,280 – 1,290 area.

So we are approaching a place where a pullback or consolidation would make sense. The spread trade idea didn't do much in its 1st day. If we move higher on Friday and remain overbought with bearish expectations I will look to take profits on the long leg. I will leave the short leg in place since the edge there is getting more elevated. Details in the trade ideas section below.

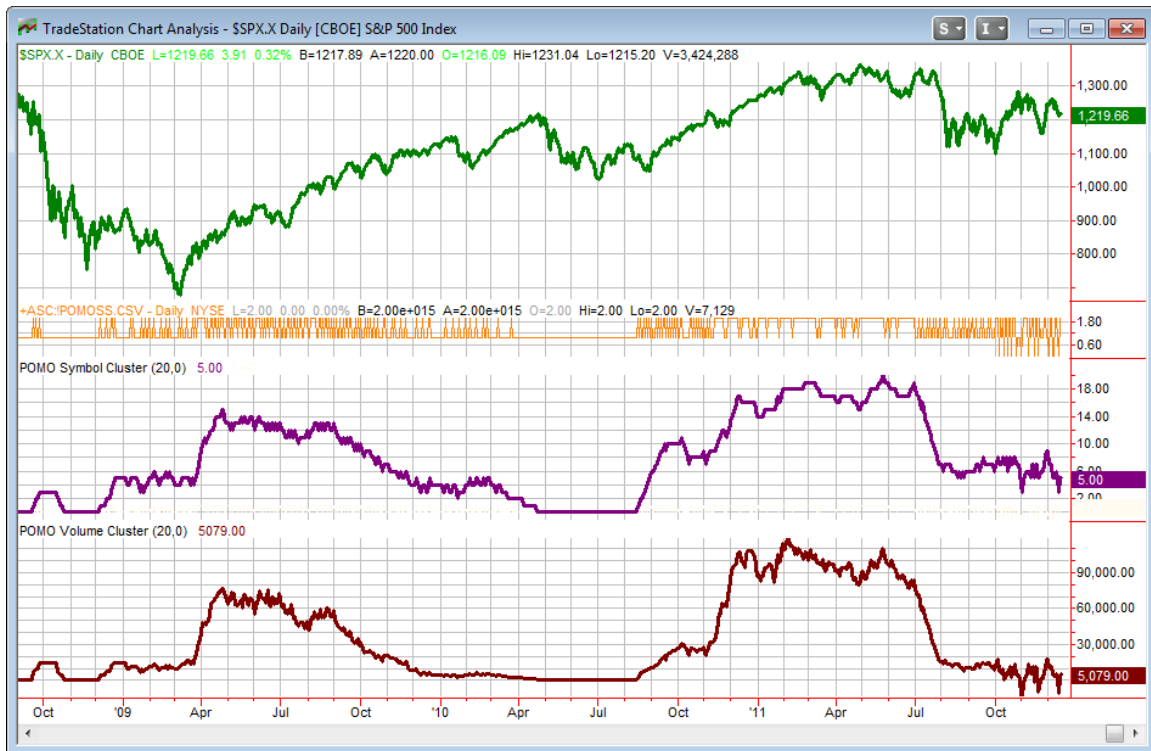
Intermediate-term Outlook (2 weeks – 2 months)– updated 12/19 – somewhat bullish

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	\$6.88	40.12%	\$5.29	may take profits before Jan
SPY(1/4)(S)	12/22/2011	\$124.63	\$125.27	-0.51%		shorted at open
QQQ(1/4)	12/22/2011	\$55.22	\$55.60	0.69%		sell @ \$56.15 limit

I will look to exit QQQ at \$56.15 on Friday. This is about 1% above Thursday's close and just below QQQ's 200ma. If not filled by the close I will sell at a limit of \$55.65 on close.

XIV declined a bit today for the 1st time in a while. As we get closer to the end of next week I may just take profits on this one. With December options expiring on Wednesday the contango isn't as strong as it was (though it is still bullish for XIV). I could change my mind on this if my intermediate-term outlook improves further. But I am only "somewhat bullish" at the moment and with the contango now less appealing, I might just take profits as we near the end of this strong seasonal period.

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