

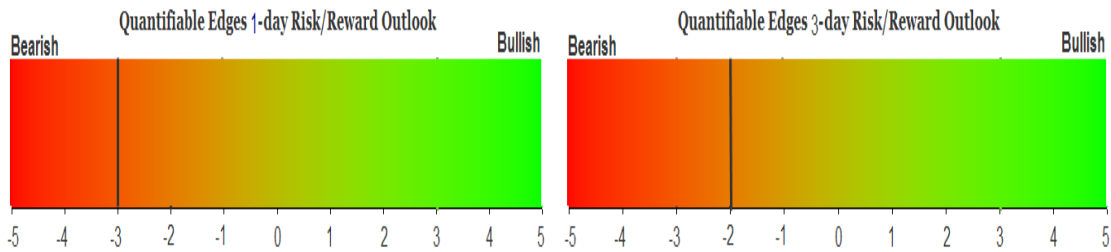
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 28, 2011

Volume 4 Issue 250

Market Overview



Signals Overview

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

Tonight's Research Points

- 5 higher closes in an uptrend that is not making new 50-day highs has historically suggested a strong market that is likely to continue higher over the next few weeks.
- The VIX and SPX both closing up the same day is a setup that has been followed by short-term weakness.

Short-term Outlook

The Bottom Line

I'm still looking for a dip, but time is running out. I am maintaining my small short position at this point.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
December 28, 2011	VIX up SPX up 10-day high.	1-2 days	Bearish	
December 28, 2011	5 Days Up > 200 no 50-high	1-10 days	Bullish	
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 28, 2011	5 Days Up > 200 no 50-high	1-15 days	Bullish	
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

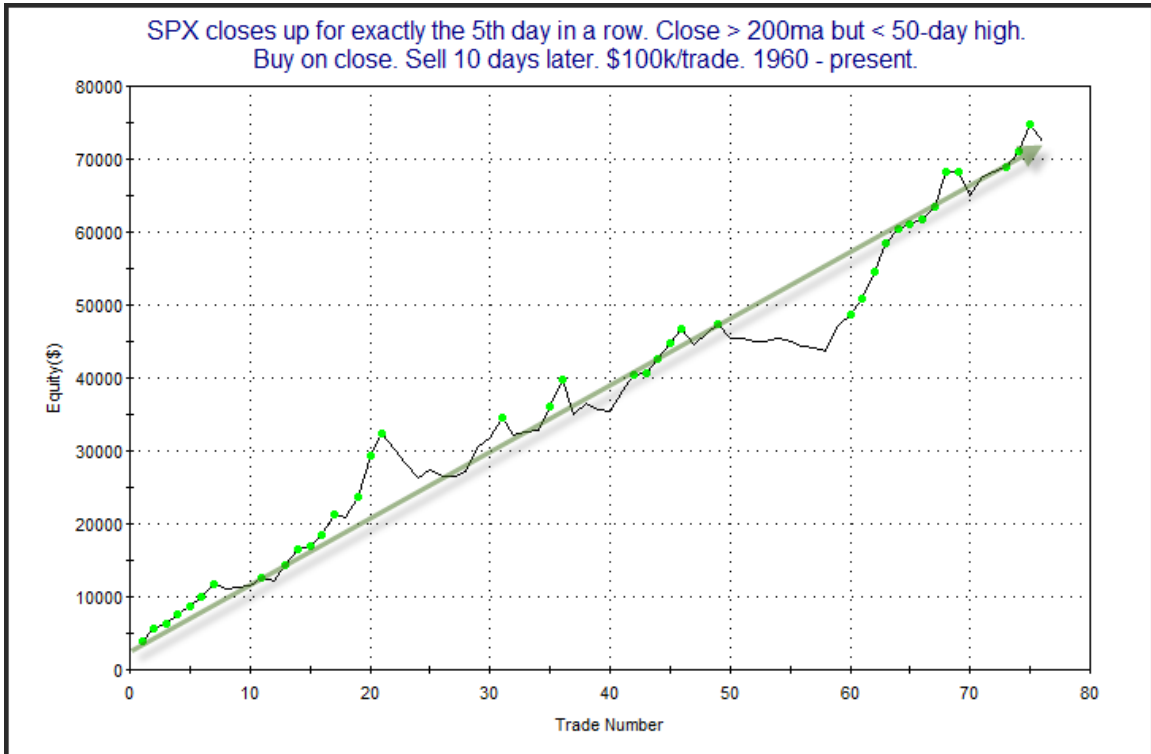
If you didn't trade on Tuesday you weren't the only one. And you didn't miss much either. The indices finished mixed, though the 3 I typically look at were all slightly higher. The SPX gained a paltry 0.01%, the Nasdaq was up 0.25%, and the Russell 2000 gained 0.5%. Breadth was slightly negative as the NYSE Up Issues % came in at 49% and the Up Volume % was just 42%. Total NYSE volume was again extremely light – even below Friday's level.

When the market begins to get overbought it will often suggest a pullback is likely. When overbought gets powered through then odds will sometimes shift from a pullback to a continuation of that move. Below is a study that demonstrates this concept. It was last seen in the 7/5/11 subscriber letter.

SPX closes up for exactly the 5th day in a row. Close > 200ma but < 50-day high.
Buy on close. Sell X days later. \$100k/trade. 1960 - 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
15	104,930.23	74	50	24	67.57	2,832.66	8,288.00	-1,529.28	-4,879.10	1.85	3.86	1,417.98
14	92,032.17	74	49	25	66.22	2,674.44	8,272.60	-1,560.61	-4,738.50	1.71	3.36	1,243.68
13	92,569.87	74	54	20	72.97	2,427.12	6,401.50	-1,924.72	-3,773.44	1.26	3.40	1,250.94
12	85,027.39	75	54	21	72.00	2,250.42	5,925.50	-1,737.88	-3,661.77	1.29	3.33	1,133.70
11	70,534.74	76	51	25	67.11	2,100.41	6,110.00	-1,463.44	-4,887.00	1.44	2.93	928.09
10	72,291.50	76	54	22	71.05	1,875.36	5,675.25	-1,317.19	-4,684.28	1.42	3.49	951.20
9	67,664.64	76	50	26	65.79	1,953.37	5,228.75	-1,153.99	-4,910.55	1.69	3.26	890.32
8	61,276.58	77	53	24	68.83	1,662.97	5,146.50	-1,119.20	-3,376.64	1.49	3.28	795.80
7	53,640.44	77	50	27	64.94	1,682.33	5,698.75	-1,128.74	-3,500.70	1.49	2.76	696.63
6	45,295.84	77	54	23	70.13	1,413.79	5,134.75	-1,349.94	-3,359.36	1.05	2.46	588.26
5	37,465.03	77	53	24	68.83	1,245.30	4,476.75	-1,189.00	-3,716.53	1.05	2.31	486.56
4	27,481.43	77	51	26	66.23	1,061.07	3,983.25	-1,024.35	-3,494.78	1.04	2.03	356.90
3	26,404.71	77	51	26	66.23	1,021.40	2,796.50	-987.95	-3,359.36	1.03	2.03	342.92
2	13,427.23	77	50	27	64.94	773.77	2,479.25	-935.60	-3,748.50	0.83	1.53	174.38
1	8,507.43	77	48	29	62.34	517.98	2,211.54	-563.98	-2,193.72	0.92	1.52	110.49

These results appear to suggest a pretty consistent upside edge over the next 1-3 weeks. Below is an equity curve using the highlighted 10-day hold that shows how this edge has played out over time.



This appears to be quite a consistent curve and makes the study even more compelling. I have also added it to the intermediate-term list since the bullish impact appears to persist for up to 3 weeks.

Other interesting action appeared as the VIX rose along with the market today. Most of the time the VIX and SPX will trade in opposite directions. The VIX has a natural tendency to fall on Fridays and rise on Mondays. Therefore I will often examine those days separately. The study below looked at midweek occurrences when they both rose. It was last seen in the 9/16/10 subscriber letter and has been updated.

SPX and VIX both close higher. Today is Tuesday, Wednesday, or Thursday. SPX > 200ma and at a 10-day high. Buy on close. Sell X days later. \$100k/trade. 1999 - 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	-14,098.29	55	28	27	50.91	757.98	2,288.73	-1,308.21	-4,171.80	0.58	0.60	-256.33
4	-15,292.92	57	24	33	42.11	861.17	2,343.30	-1,089.73	-4,354.72	0.79	0.57	-268.30
3	-10,308.57	57	25	32	43.86	713.39	2,381.25	-879.48	-2,337.28	0.81	0.63	-180.85
2	-12,790.21	58	21	37	36.21	586.69	1,609.50	-678.67	-2,182.68	0.86	0.49	-220.52
1	-9,388.81	66	29	37	43.94	357.55	1,281.75	-534.00	-1,721.70	0.67	0.52	-142.25

88% of instances posted at least 1 close below the entry price at some point in the next week.

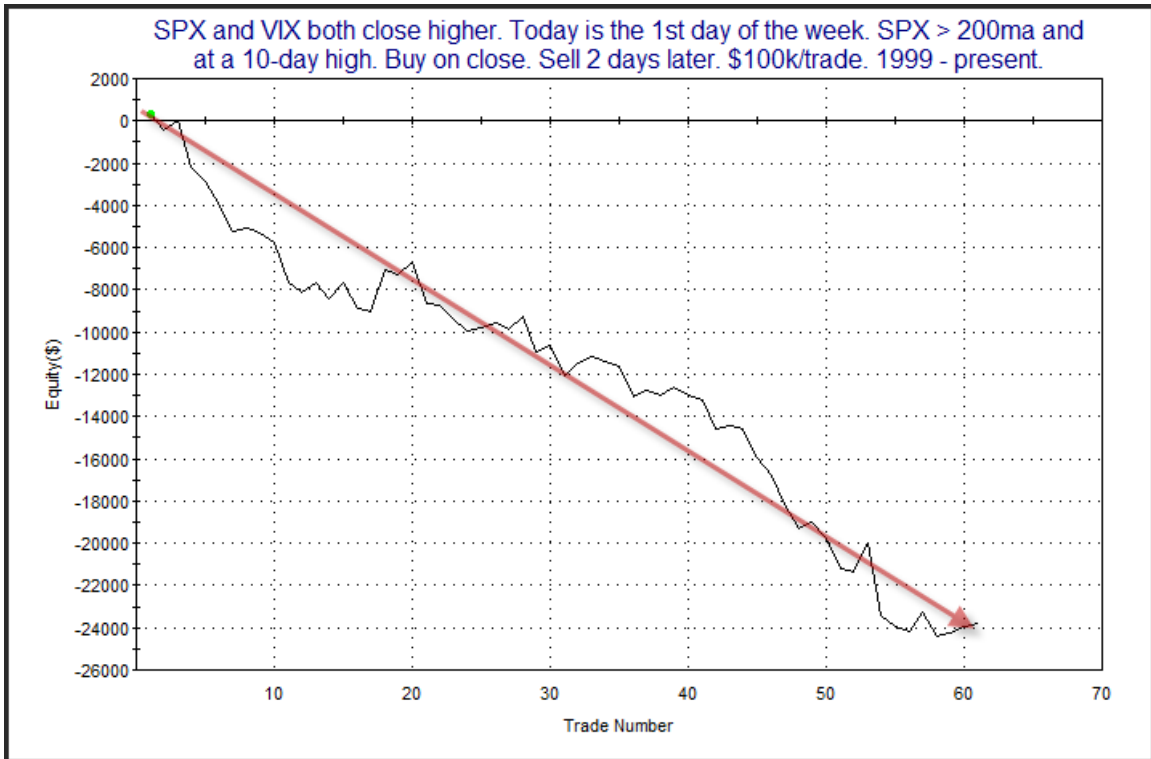
The average drop isn't terribly deep but the downside consistency is solid. But today wasn't a typical Tuesday. Since the market was closed on Monday, it was not the 2nd day of the week, but the 1st. As I mentioned, Monday's have a natural inclination to see the VIX rise. So I re-ran the previous test and required today be the 1st day of the week (Monday or otherwise). Results are below.

SPX and VIX both close higher. Today is the 1st day of the week. SPX > 200ma and at a 10-day high. Buy on close. Sell X days later. \$100k/trade. 1999 - 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	-19,091.19	58	24	34	41.38	1,228.85	3,260.25	-1,428.93	-5,048.68	0.86	0.61	-329.16
4	-20,050.19	61	24	37	39.34	1,011.32	2,953.65	-1,197.89	-4,271.52	0.84	0.55	-328.69
3	-22,746.84	61	22	39	36.07	846.51	2,641.80	-1,060.77	-3,887.84	0.80	0.45	-372.90
2	-23,756.04	61	22	39	36.07	499.80	1,981.72	-891.07	-3,372.16	0.56	0.32	-389.44
1	-15,409.55	61	19	42	31.15	334.90	1,004.25	-518.40	-1,580.04	0.65	0.29	-252.62

89% of instances posted at least 1 close below the entry price at some point in the next week.

Somewhat surprisingly these results appear even more bearish. Like the previous test the downside edge appears to max out after 2 days. Below is a profit curve assuming a 2-day holding period.



This is a very steady downside edge, especially considering the 200ma filter. For purposes of generating estimates I elected to average the 2 VIX-related studies.

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



The green Aggregator line now just barely negative at -0.004. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the black Differential Line remains solidly below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are mildly bearish and the SPX is 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 before the bell.

Based on the current active studies, expectations are scheduled to turn positive on Wednesday. Part of this is the fact that 2 bearish studies are set to expire on Wednesday. Of course expectations could remain negative if new bearish evidence emerges. The Differential Pivot will be 1,242.72 on Wednesday. This is almost 1.8% below Tuesday's close. It's unlikely we'll see a decline that large during this quiet holiday period. More likely is that we will need to see a multi-day pullback or consolidation in order to work off the overbought condition and flip the Differential back to positive.

I still have a small short position after covering the long part of the spread trade on Friday afternoon. Under normal circumstances I would consider adding to this short, but the fact

that expectations are set to turn positive on Wednesday is keeping me from doing that. Instead I will hold and re-evaluate tomorrow night.

Intermediate-term Outlook (2 weeks – 2 months)– updated 12/27 – somewhat bullish

Santa delivered with a 4-day rally into Christmas. In the process it took the SPX back above its 200ma and near the early December highs. It is now less than 3% below its October highs and is up slightly for 2011.

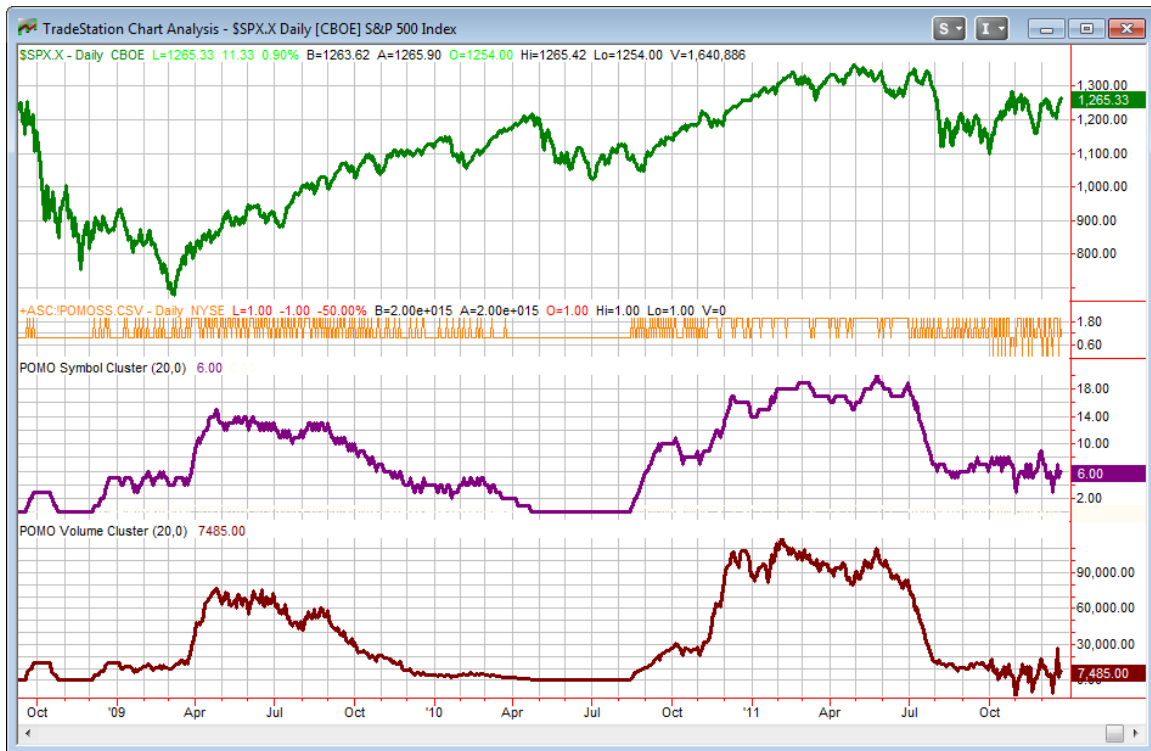
From a studies standpoint there wasn't anything new this week that triggered with long-term implications. The Triangle Breakdown study from November that predicted a move up to 1,267 before trading down as low as 1,150 is now within 2 points of fulfilling that prediction. It was a close call on the ride down as it got pretty close to 1,150 after the initial breakdown in late November.

This is the last week of strong seasonality and we will soon see several of the intermediate-term studies come off the board – both bullish and bearish. The only 2 with much of a shelf-life at this point are the bullish Follow Through Day study from the October FTD and the bearish POMO indications based on recent Fed activity.

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 *withdrew* a net \$4.8 billion from the system with sales stronger than purchases. The net volume over the last 20 days is now \$7.5 billion injected, which is in the middle of its recent range.

The bad news is that this upcoming week there are no purchases scheduled but there is an estimated \$8 – \$8.75 billion of scheduled sales, which in effect will pull more liquidity from the system.

The intermediate-term is somewhat mixed. We are still seeing a mix of bullish and bearish studies. POMO is looking worse, but seasonality may allow the momentum to carry the market up for another week. I'm still just slightly bullish but anticipate turning neutral after this week. Of course this could change as action unfolds and new studies emerge. From a trading perspective my outlook simply means I will be playing shorts a bit more conservatively than longs.

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	\$6.75	37.47%	\$5.29	may take profits before Jan
SPY(1/4)(S)	12/22/2011	\$124.63	\$126.49	-1.49%		Aggregator

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