

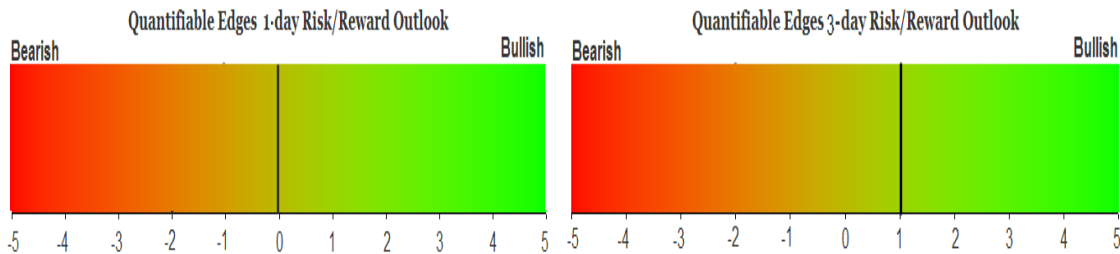
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 17, 2012

Volume 5 Issue 10

Market Overview



Signals Overview

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

Tonight's Research Points

- MLK & January op-ex weeks often overlap. And over the last 13-14 years they have both fared poorly.
- POMO activity has been very weak but it is expected to pick up some from now until the end of the month. This is a potential positive.
- The Nasdaq has begun to outperform the SPX in recent weeks and that is a positive for the intermediate-term.

Short-term Outlook

The Bottom Line

The Aggregator is suggesting a slight bullish edge. It isn't enough for me to take on long exposure just yet. I'm awaiting more compelling evidence and reward/risk opportunity before taking a position.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
January 17, 2012	MLK/Jan opex week bearish	1-4 days	Bearish	
January 12, 2012	Breakout then inside day	1-5 days	Bullish	1.50%
January 11, 2012	Breakaway gap	1-5 days	Bullish	1.70%
Active - Long Term				
January 4, 2012	2 of 3 days Up Issue %>75. 10-high.	1-18 days	Bullish	
December 5, 2011	POMO activity flat to negative	int term	Bearish	
October 19, 2011	FTD on strong breadth/20day high	int term	Bullish	
Dropped Tonight				
December 28, 2011	5 Days Up > 200 no 50-high	1-15 days	Bullish	
October 30, 2011	SPX & bond yields hit 50-day highs	1-50 days	Bearish	
January 12, 2012	SPX 50-high. VIX up midweek.	1-2 days	Bearish	-0.80%
January 13, 2012	VIX:VXV < 0.85.	1 day	Bearish	

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

The Evidence

After exhibiting much weakness throughout the day on Friday, a late surge left things looking less dire. Still the major indices were all lower. The SPX and Nasdaq lost 0.5% and the Russell 2000 lost 0.8%. Breadth was solidly negative as the NYSE Up Issues % came in at 35% and the Up Volume % was 26%. Total NYSE volume rose slightly over the last couple of days.

The late surge helped avoid a few short-term bearish studies that appeared likely to trigger. One called for a decline from a high with the NYSE Up Issues % of 33.3% or lower (decliners twice advancers). The final Up Issues % of 35% was a narrow miss. Another study called for the SPY to open and close in the upper end of its range but still gap down from a high. The late rally expanded the day's range and caused the opening price to narrowly miss. Either one of these studies would have turned expectations negative, but as you'll see below, 3-day expectations as calculated by the Aggregator remained marginally positive.

The studies that did trigger were related to the seasonal weakness that this upcoming week has experienced over the last 13-14 years. Last year in the 1/18/11 letter I looked at January op-ex and MLK week. I decided to review those studies again this weekend. The first study below looks at January op-ex week.

Today is Friday before January Op-Ex Week.
Buy SPX 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	-22,650.50	13	2	11	15.38	1,712.34	1,826.25	-2,370.47	-5,383.93	0.72	0.13	-1,742.35
4	-19,698.24	13	3	10	23.08	1,003.47	1,800.75	-2,270.87	-5,220.32	0.44	0.13	-1,515.25
3	-13,621.17	13	3	10	23.08	1,012.71	2,206.50	-1,665.93	-5,345.76	0.61	0.18	-1,047.78
2	-8,034.27	13	4	9	30.77	329.51	819.00	-1,039.15	-2,775.24	0.32	0.14	-618.02
1	-1,409.88	13	7	6	53.85	503.05	1,080.62	-821.87	-2,250.08	0.61	0.71	-108.45

2001 was the only year the SPX failed to close below Friday's close at some point during the week. Interesting about January op-ex week is that it often occurs in conjunction with Martin Luther King Day. Below is the list of 13 January op-ex weeks from the table above with their full week performance results. Note that some of these weeks contained four trading days and some contain five.

January Op-Ex Week SPX Performance.
\$100k/trade. 1999 - present.

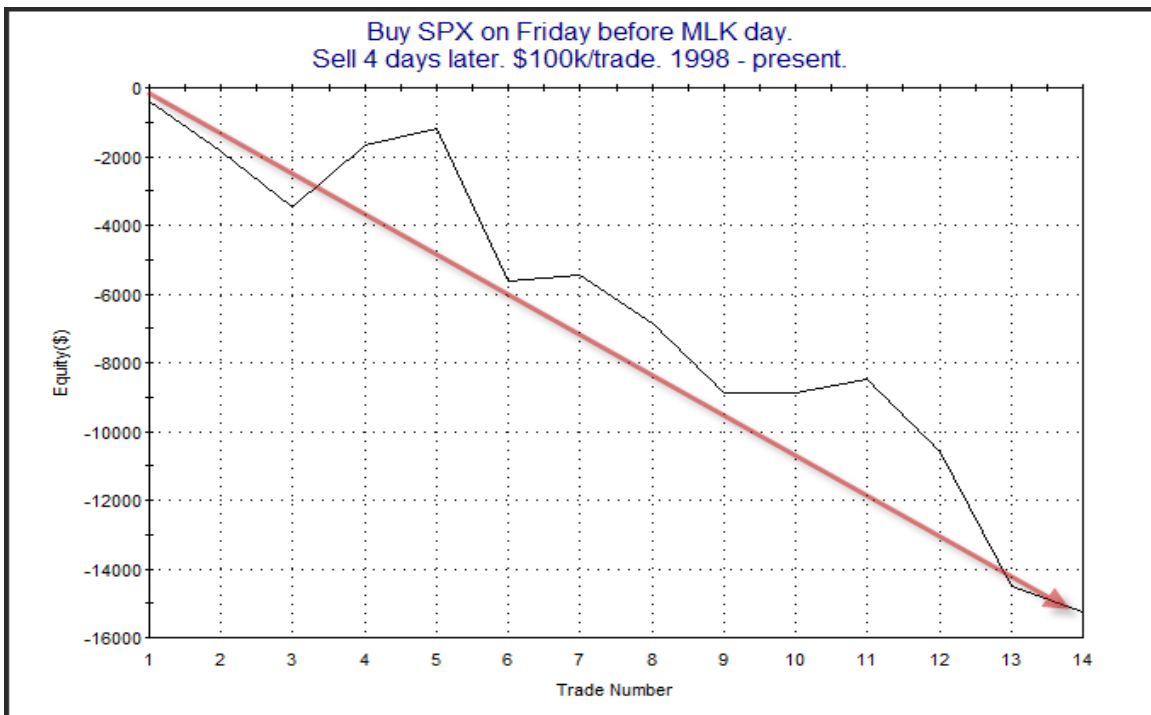
Date/Time	Signal	Price	% Profit	Run-up Drawdown
01/08/99	Buy	\$1,275.09	(2.50%)	\$88.14
01/15/99	Sell#2	\$1,243.26		(\$5,343.00)
01/14/00	Buy	\$1,465.15	(1.62%)	\$38.08
01/21/00	Sell	\$1,441.36		(\$1,809.48)
01/12/01	Buy	\$1,318.55	1.82%	\$2,700.00
01/19/01	Sell	\$1,342.56		(\$391.50)
01/11/02	Buy	\$1,145.60	(1.57%)	\$279.27
01/18/02	Sell#2	\$1,127.58		(\$1,840.05)
01/10/03	Buy	\$927.57	(2.78%)	\$800.36
01/17/03	Sell#2	\$901.78		(\$3,054.85)
01/09/04	Buy	\$1,121.86	1.60%	\$1,598.44
01/16/04	Sell#2	\$1,139.82		(\$593.63)
01/14/05	Buy	\$1,184.51	(1.41%)	\$963.48
01/21/05	Sell	\$1,167.82		(\$1,401.96)
01/13/06	Buy	\$1,287.61	(2.03%)	\$13.86
01/20/06	Sell	\$1,261.48		(\$2,055.13)
01/12/07	Buy	\$1,430.73	(0.02%)	\$313.26
01/19/07	Sell	\$1,430.50		(\$449.88)
01/11/08	Buy	\$1,401.03	(5.41%)	\$1,197.06
01/18/08	Sell#2	\$1,325.20		(\$6,284.92)
01/09/09	Buy	\$890.35	(4.52%)	\$5.60
01/16/09	Sell#2	\$850.12		(\$8,210.72)
01/08/10	Buy	\$1,144.98	(0.78%)	\$472.41
01/15/10	Sell#2	\$1,136.03		(\$1,182.33)
01/14/11	Buy	\$1,293.24	(0.76%)	\$217.14
01/21/11	Sell	\$1,283.35		(\$1,692.46)
Avg Drawdown: -\$2,639.22				
Max Run-up: \$2,700				
Avg Run-up: \$668.24				

As you can see there has been a decided downside tendency over the last 13 years. The drawdown / run-up stats at the bottom are especially compelling for the bears.

I also decided to separately look at MLK weeks. The NYSE has only observed MLK Day as a holiday since 1998. So here we only have 14 years of data. Below is a stats table showing how the market has performed.

Buy SPX on Friday before MLK day. Sell X days later. \$100k/trade. 1998 - 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
4	-15,267.21	14	4	10	28.57	714.65	1,800.75	-1,812.58	-4,441.80	0.39	0.16	-1,090.51
3	-5,050.65	14	5	9	35.71	1,029.34	2,206.50	-1,133.04	-2,646.54	0.91	0.50	-360.76
2	-1,211.26	14	8	6	57.14	596.81	1,068.80	-997.63	-2,576.20	0.60	0.80	-86.52
1	-4,348.58	14	7	7	50.00	775.01	1,776.32	-1,396.24	-5,253.30	0.56	0.56	-310.61

As you would suspect with all the overlap from op-ex week, MLK week numbers are also very poor. Below is an equity curve illustrating how MLK week has performed over the last 14 years.



Bottom line from a seasonality standpoint is that January op-ex and MLK week have exhibited a bearish tendency over the last 13-14 years. The bearish tendency appears strong enough to consider including it on the Active List and as part of the Aggregator calculation.

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



Despite the bearish seasonal studies study tonight the green Aggregator line is still slightly positive. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line inched up a little above 0. A positive Differential reading means the SPX has underperformed expectations over the last few days. So net expectations are slightly bullish and the SPX is marginally oversold versus recent expectations. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. This caused the Aggregator System to turn from flat to long.

Based on the current active studies, expectations are scheduled to turn negative on Tuesday. Of course this could change if more bullish evidence emerges. The Differential Pivot will be 1,292.48 on Tuesday. This is less than 0.3% above Friday's close. So it won't take much of a rally on Tuesday for the SPX to be considered overbought and the Differential Line to turn negative.

So the Aggregator is long, but this is one of those unusual times where the Aggregator is suggesting an edge, but I don't think it is one strong enough to initiate a trade. There are a few reasons for this:

- 1) The Aggregator value is only slightly positive, and with 2 bearish studies just missing I question the upside expectation reading.
- 2) The Differential reading is also very close to 0 – suggesting only a very slight oversold reading.
- 3) Expectations are due to turn negative on Tuesday, so the window of opportunity to profit appears very short.

With all this in mind I am not inclined to take on new exposure at this point. I believe a little patience at this point will provide us with a higher reward/risk opportunity. I'm in "wait and see" mode.

Intermediate-term Outlook (2 weeks – 2 months)– updated 1/17 – somewhat bullish

New rally highs were made in the SPX this past week as it continues its march towards the April/May 2011 highs. The October 2011 highs were surpassed, marking a notable achievement. Now we'll keep an eye out on volume, breadth measures, momentum, and other possible divergences for clues going forward.

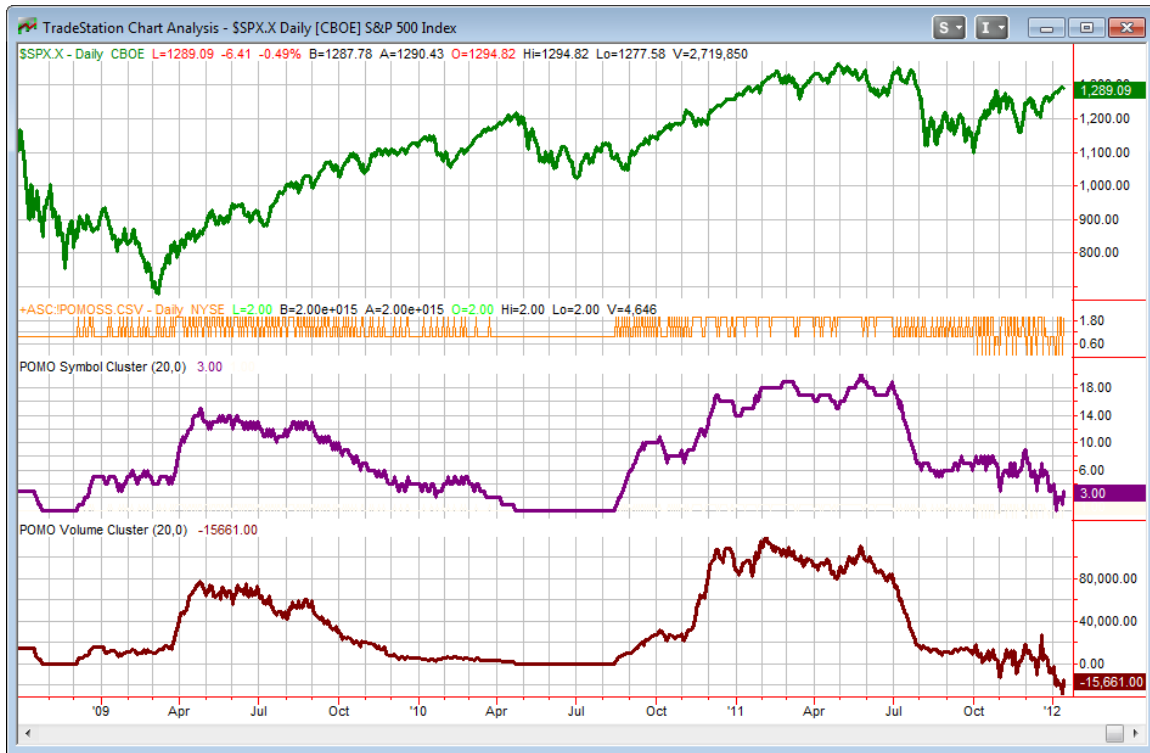
One notable observation is that POMO is about to start looking better.

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>

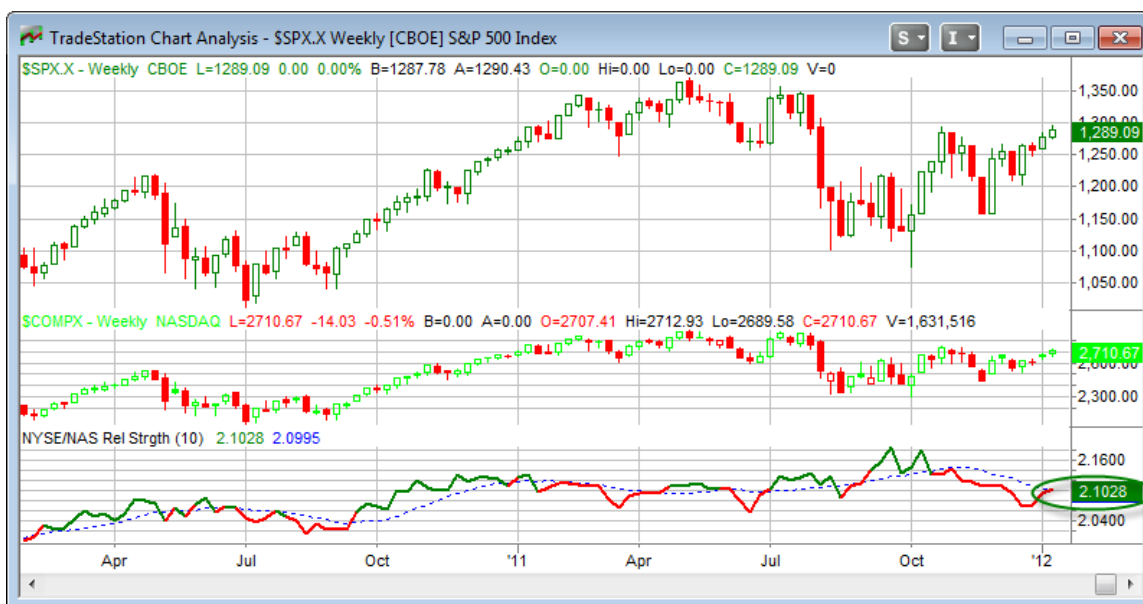


For the 4th week in a row POMO numbers showed a net withdrawal of liquidity as the Fed siphoned another \$9.2 billion from the system. This kept our POMO indicators at extremely low levels.

But POMO activity over the last month has not appeared to have a strong negative impact on the market. There is often a slight delay, so perhaps it will combine with negative seasonality this week to offer the bears an opportunity to sell the market off some. POMO won't continue to exert a negative liquidity flow though.

There will be a substantial amount of buying over the last few weeks of January, and scheduled selling is minimal. This will cause a jump in our POMO indicators from now through the end of January when the next POMO schedule will be released. It will also result in net positive liquidity flows and could act as a tailwind for the bulls.

Another potential positive for the bulls is that the Nasdaq is now outperforming the SPX. Below is the SPX/Nasdaq Weekly Relative Strength chart from the charts page.



I've circled the reading at the bottom of the chart. It is now appearing in green rather than red, indicating the line color is about to change because the Nasdaq has now taken over the lead from the SPX. This is important because since near the end of 1971 (which is the 1st possible new signal after the inception of the Nasdaq) the SPX generated over 100% of its positive performance when the Nasdaq has been leading. Over that time the SPX has gained 1,352.95 points when the Nasdaq has been in the lead. Since the SPX only sits at 1,289.09 today you can easily see how important a leading Nasdaq has been over the last 40 years. More details on this indicator can be found in the blog posts below.

<http://quantifiableedges.blogspot.com/2009/05/simple-powerful-timing-indicator.html>

<http://quantifiableedges.blogspot.com/2009/06/tweaking-nasdaq-leadlag-model.html>

Additionally, for those subscribers that are interested in exploring this indicator more on their own, they may download the model in either Excel or Tradestation format from the downloads page of the members site at any time.

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

So the intermediate-term appears to be looking up a bit. The SPX made new rally highs and has spent nearly 2 weeks above its 200ma. The Nasdaq is taking over upside

leadership and there also appears to be strong upside momentum with a POMO tailwind about to begin. Lastly, we are in the window of the strong breadth study from a couple of weeks ago. So my outlook has improved, and once we get past this next seasonally bearish week it could improve even more. From a trading standpoint this simply means I will take a more aggressive approach with longs than with shorts.

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
MO(1/3)	1/5/2012	\$28.40	\$28.96	1.97%		<i>Sell on open</i>

MO finally hit its exit target and will be closed out on Tuesday's open.

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