

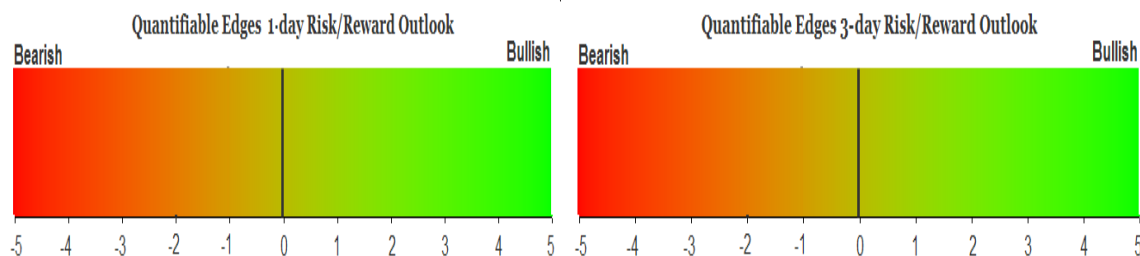
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 26, 2012

Volume 5 Issue 17

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Flat	50% Long XIV	Flat	Flat

Tonight's Research Points

- When the SPY has closed at a 100-day high on a Fed day it has always shown some follow-through during the next week.

Short-term Outlook

The Bottom Line

Bullish evidence has turned the Aggregator neutral and I am looking to reduce my short exposure.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
January 26, 2012	SPX 100-day high on Fed Day	1-6 days	Bullish	1.60%
January 23, 2012	SPX up 1%-2% op-ex week	1-4 days	Bearish	
Active - Long Term				
January 17, 2012	Nasdaq leading SPX	int term	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				
January 24, 2012	SPX 50-high. VIX up.	1-2 days	Bearish	
January 20, 2012	Op-ex Thursday closes near high	1-4 days	Bearish	-1.60%

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

The Evidence

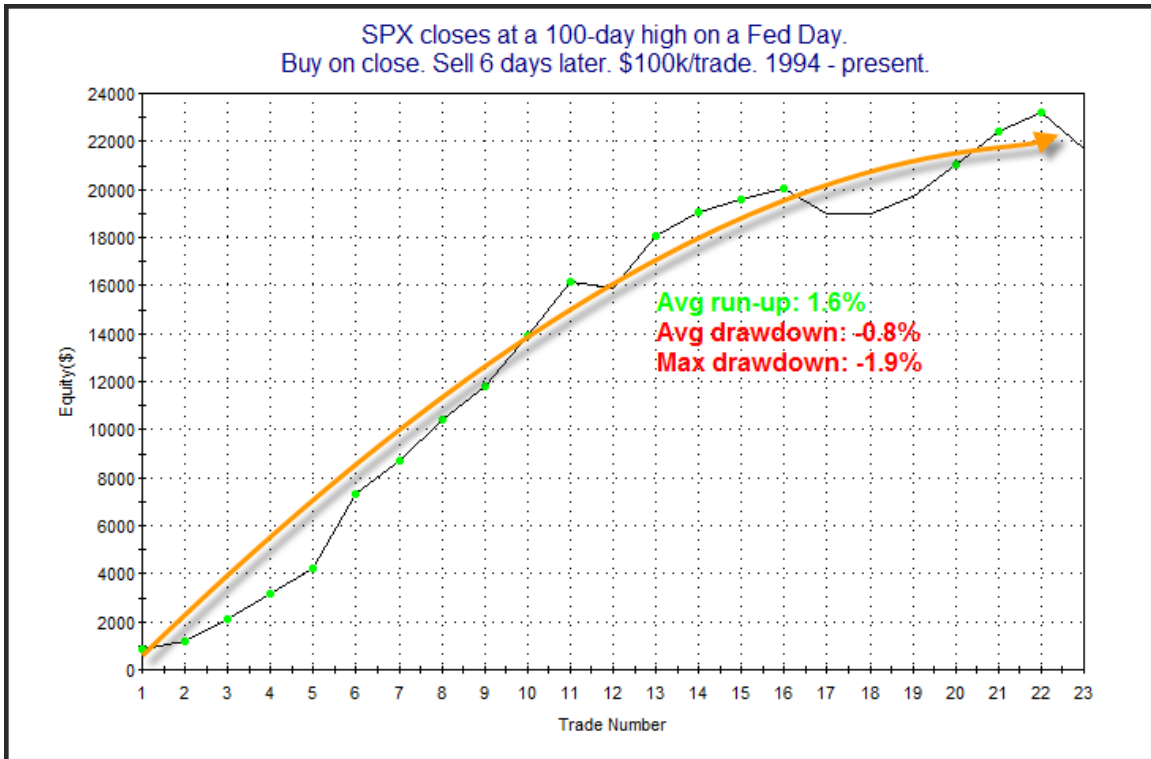
The Fed spoke. The market liked it, and a rally ensued. The SPX and Russell 2000 each gained 0.9% and the Nasdaq rallied 1.1%. Breadth finished strongly positive as the NYSE Up Issues % came in at 76% and the Up Volume % was 78%. Total NYSE volume rose quite a bit from the last 2 days.

In “The Quantifiable Edges Guide to Fed Days” I discussed Fed Days that close at new highs. The basic finding was that when the market closed at a short-term high on a Fed Day, then it was likely to pull back over the next few days. But when it closed at a long-term high, then the rally was likely to continue. Below is a study from the guide that last appeared in the 4/28/11 Subscriber Letter.

SPX closes at a 100-day high on a Fed Day. Buy on close. Sell X days later. \$100k/trade. 1994 - 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	23,244.62	23	17	6	73.91	1,836.24	5,492.11	-1,328.57	-2,161.08	1.38	3.92	1,010.64
9	25,131.05	23	18	5	78.26	1,848.47	5,708.74	-1,628.30	-2,346.69	1.14	4.09	1,092.65
8	27,735.37	23	19	4	82.61	1,550.87	3,995.65	-432.78	-854.00	3.58	17.02	1,205.89
7	21,015.62	23	19	4	82.61	1,266.35	3,198.09	-761.23	-1,290.24	1.66	7.90	913.72
6	21,696.27	23	20	3	86.96	1,223.85	3,147.85	-926.25	-1,500.88	1.32	8.81	943.40
5	18,400.18	23	19	4	82.61	1,117.44	2,353.88	-707.79	-1,077.30	1.58	7.50	800.01
4	16,210.41	23	17	6	73.91	1,171.96	3,173.92	-618.82	-945.00	1.89	5.37	704.80
3	9,195.05	23	15	8	65.22	910.00	2,227.50	-556.88	-931.77	1.63	3.06	399.78
2	10,199.13	23	15	8	65.22	989.29	2,314.87	-580.03	-1,562.33	1.71	3.20	443.44
1	6,138.73	23	16	7	69.57	617.08	2,073.34	-533.50	-1,393.26	1.16	2.64	266.90

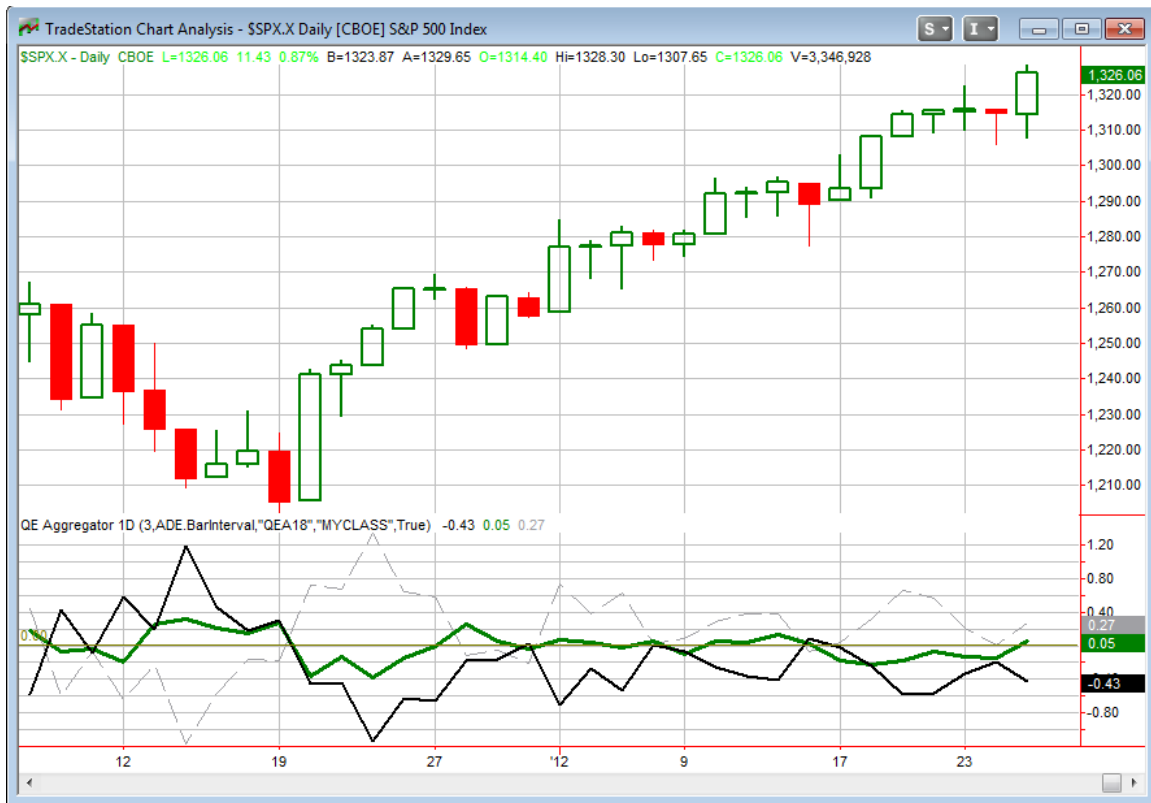
All 23 instances posted a close above the Fed Day close at some point in the next week.

This suggests further upside is likely over the next 1-2 weeks. Below is a profit curve assuming a 6-day exit strategy.



The equity curve is has some fade lately but still appears to suggest an edge. The runup/drawdown stats are especially compelling. In all, risk/reward has been strongly favorable for the long side under these scenarios.

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



Tonight's study helped push the green Aggregator line into positive territory. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line remains well below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are bullish but the SPX is still overbought versus recent expectations. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. This caused the Aggregator System to change from short to flat at the close. This was indicated as likely on the systems page shortly before the close.

Based on the current active studies, expectations are scheduled to remain positive on Thursday. Of course this could change if bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,310.72 on Thursday. This is 1.2% below Wednesday's close. So it will take a drop of at least this much in order for the Differential Line to turn positive.

With bullish evidence now turning expectations positive I will look to cover my short SPY position. The market is certainly overdue for a pullback, and there is a decent chance that waiting for one would provide a better exit point. But without quantifiable

evidence suggesting a downside edge, I'd rather just step aside and await a better spot to step back in (either long or short).

Unless there is a big gap down the short SPY position will be the first losing trade idea of 2012. That happens and I'm glad that I did not get aggressively positioned. With the positive short-term POMO, the intermediate-term uptrend, and the bullish intermediate-term outlook I never felt this was worth more than a ¼ size position. So taking a loss here doesn't hurt much. One of my primary goals in 2012 is to make sure I bet big when I feel the edge is strongly in my favor and to keep risk lower when edges appear moderate. That is sometimes easier said than done and always open to interpretation, but using appropriate aggressiveness helps greatly over the long haul.

Despite the Aggregator System turning neutral I will stick with my short DIA trade idea for now. That one is based on system -80514 and I will likely stick to it until the system triggers an exit.

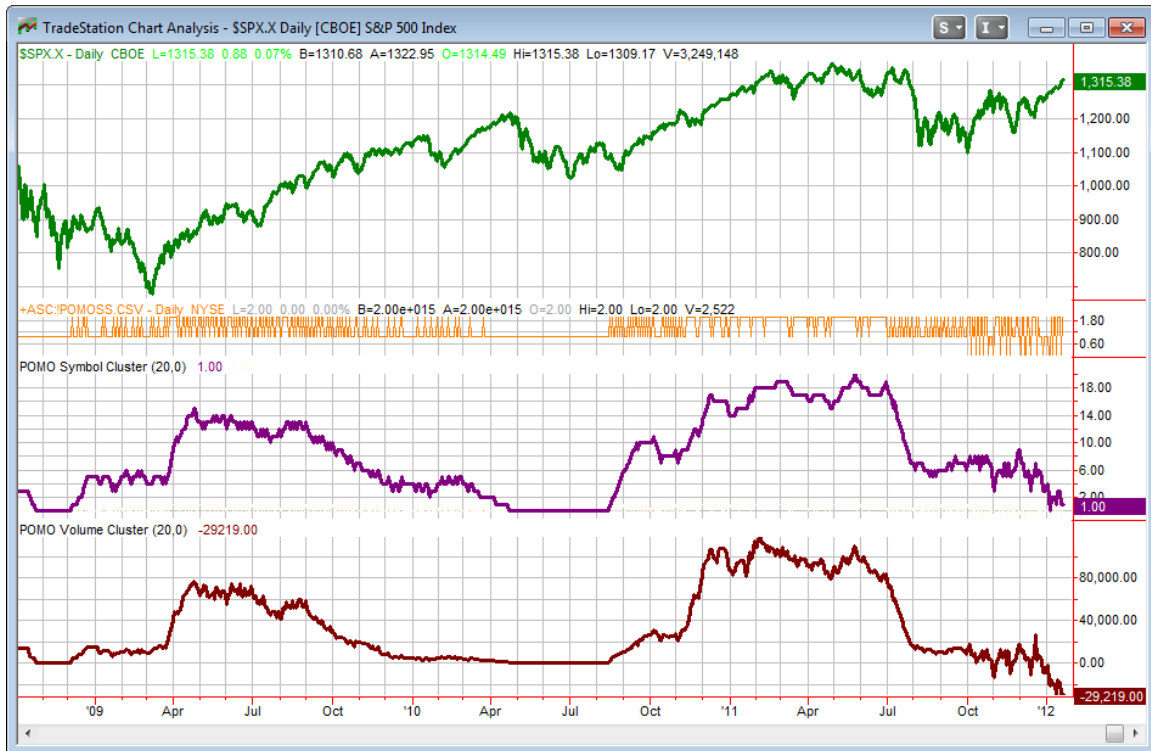
Intermediate-term Outlook (2 weeks – 2 months)– updated 1/23 – bullish

The SPX again hit new rally highs this week as it posted a rare all-up op-ex week. Despite overbought readings and bearish short-term studies the long-term trend and momentum pushed forward. Both continue to look good.

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 first time in five weeks POMO numbers showed net gains. The fed added about \$5.9 billion to the system. But because an even bigger week came off the back end of our POMO indicator calculations, we are still seeing strongly negative net volume over the last 20 days. This should flip this upcoming week as several negative and neutral days will be falling out of the calculation and several positive days are scheduled.

The negative POMO numbers are running out of time to exhibit a bearish impact on the market. If the market can continue to rally despite all the negative readings we've seen in the last few weeks then that could be a very bullish sign. It has been several years since the market has managed to rally strongly without the aid of liquidity inflows from the Fed. The rest of January is slated to see primarily POMO buying, and that could aid in helping the market continue to rally higher over the next few weeks.

So the intermediate-term still appears to be looking up. The SPX again made new rally highs. The Nasdaq is still in a leadership position, and there also appears to be strong upside momentum with a POMO tailwind just begun. So my outlook remains bullish. 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
SPY(1/4)(s)	1/19/2012	\$131.22	\$132.56	-1.02%		cover @ \$132.56 limit
DIA(s)	1/23/2012	\$126.96	\$127.25	-0.23%		System -80514

I'll look to cover SPY at a limit of \$132.56, which is Wednesday's close. I won't chase a gap up but will instead wait for it to pullback and fill before covering. I will place a stop \$0.50 above the open in case it decides to run after gapping up. Part of my confidence in using a limit price instead of simply covering on the open is thanks to a daytrading site I like to refer to: [MasterTheGap.com](#). Scott Andrews posts odds each night of the gap filling based on different scenarios, and gap fills on up gaps all look highly probable for Thursday.

I will cover DIA on a close < \$125.84 as per the system -80514 rules.

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