

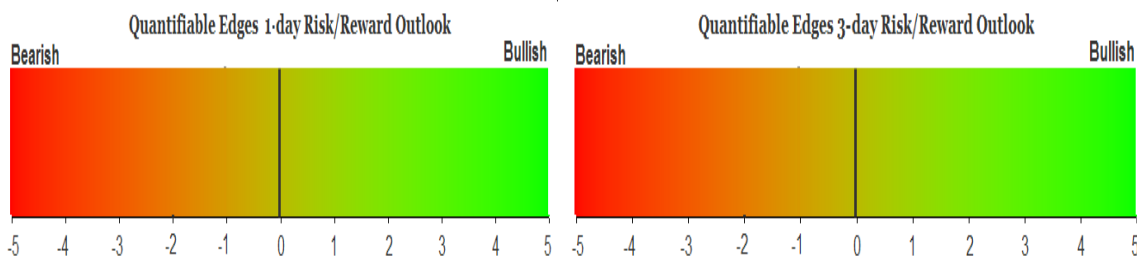
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 30, 2012

Volume 5 Issue 19

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- Strong breadth despite a weak SPX is often followed by a rising SPX over the next few days.
- A golden cross is set to occur this upcoming week, which suggests a bullish environment.
- While POMO numbers have fallen off recently, the market may be benefitting from liquidity provided to Europe in the form of swaps.

## *Short-term Outlook*

### *The Bottom Line*

The SPX has pulled back the last couple of days and is nearing a point where I would consider getting long.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
January 30, 2012	SPX down. Up Issues % > 55%.	1-2 days	Bullish	
January 26, 2012	SPX 100-day high on Fed Day	1-6 days	Bullish	1.60%
<b>Active - Long Term</b>				
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	

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

### The Evidence

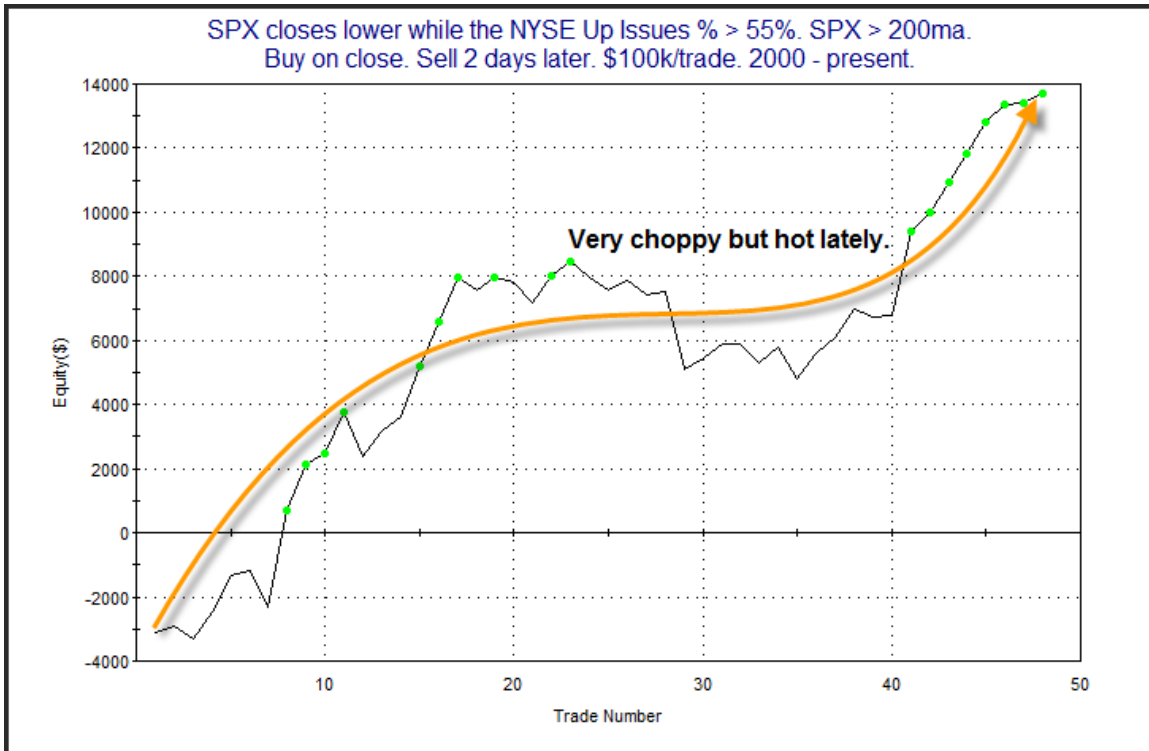
A weak morning was followed by a strong afternoon on Friday. With a short time to go the SPX was in positive territory, but some strong selling in the last 5 minutes put it back near the middle of its daily range and down on the day. Some other indices still posted gains. The SPX finished with a 0.2% decline while the Nasdaq rose 0.7% and the Russell 2000 gained 0.7%. Breadth was positive as the NYSE Up Issues % came in at 63% and the Up Volume % was 50.3%. Total NYSE volume was down a little from Thursday.

One study identified by the Quantifinder suggests a bit of an upside edge. It considered the strong breadth on a day the SPX declined. The study was last seen in the 6/8/11 letter. Results are updated.

SPX closes lower while the NYSE Up Issues % > 55%. SPX > 200ma. Buy on close. Sell X days later. \$100k/trade. 2000 - 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	17,100.81	45	29	16	64.44	1,346.84	3,616.92	-1,372.34	-4,012.80	0.98	1.78	380.02
4	16,109.12	46	28	18	60.87	1,325.91	3,429.00	-1,167.57	-2,921.28	1.14	1.77	350.20
3	15,364.12	48	33	15	68.75	928.51	2,923.44	-1,018.46	-2,852.01	0.91	2.01	320.09
2	13,713.79	48	34	14	70.83	782.71	3,025.12	-921.31	-3,119.03	0.85	2.06	285.70
1	9,860.88	50	30	20	60.00	656.42	2,310.88	-491.59	-1,348.29	1.34	2.00	197.22

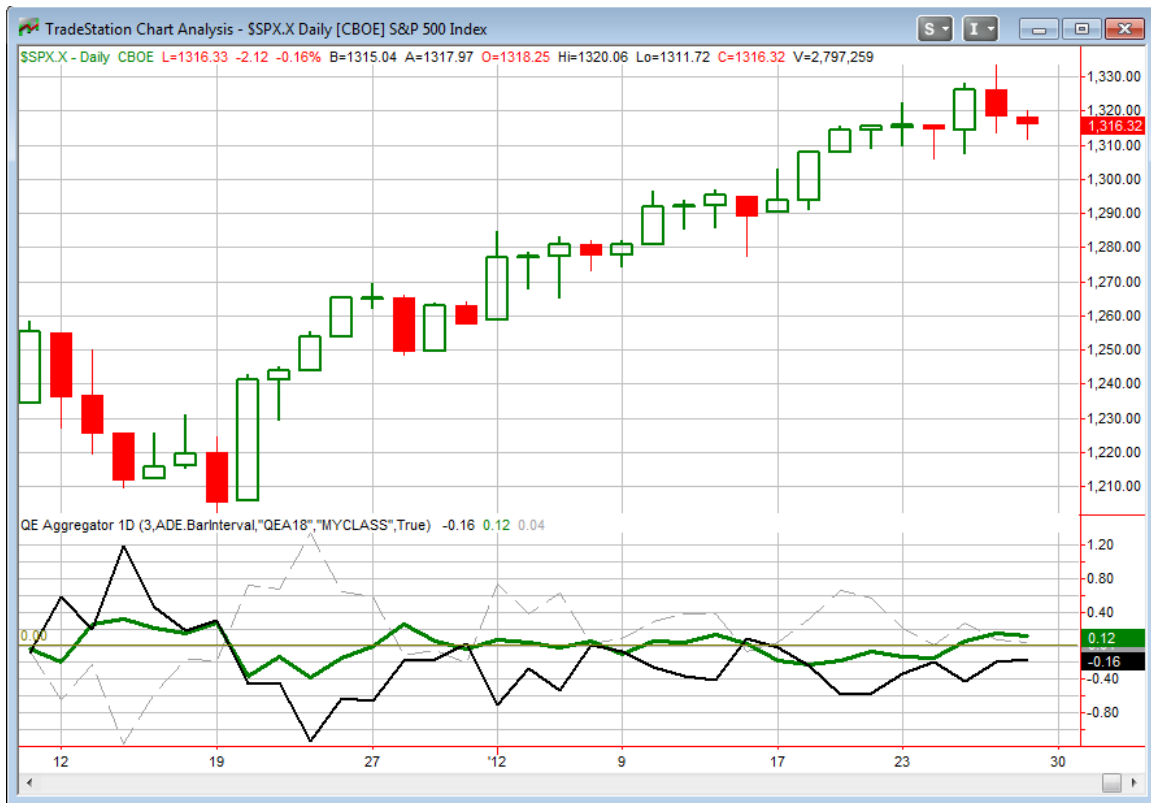
**88% of instances posted a close above the entry price at some point in the next week.**

The edge isn't huge, but it does appear to be high-percentage. The equity curve below gives a better idea of how the edge has played out over time.



While the curve certainly appears choppy, the edge has been quite strong lately. The 3-5 day charts don't see quite as pronounced of a dip in the middle, which also alleviates some concern. I believe this study is worth taking into consideration and I've included it among the active studies.

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



Without any short-term bearish studies the green Aggregator line remains in 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 is still 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 remain 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 Monday. This could easily change if bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,322.96 on Monday. It is important to note that this is what I refer to as an *inverted* pivot. This means that a flat close would see the Differential Line flip. In this case the SPX will need to rise over 0.5% in order to keep the reading “overbought” versus expectations, and the Differential Line negative. Any decline or rally of less than 0.5% would see the Differential Line turn positive. And unless bearish evidence emerges that means that we will likely see a long signal on any decline or slight gain.

With this in mind, I'll be looking to get partially long on Monday if we get a decent dip. I mentioned in last night's letter that the SPX had not closed below its 10ma for 25 days in a row (now 26). That is an unusually long period of time, and although it doesn't necessarily mean a pullback will occur simply based on that, it certainly increases the likelihood. The 10ma isn't far away, and I'll set my SPY limit order based on a close below that number.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 1/30 – bullish***

The SPX didn't accomplish much this past week other than a consolidation. The net gain was less than 0.5%. Coming in to the week it seemed a pullback was likely in order. We have dipped slightly the last 2 days and perhaps it will continue down here (a bit later than expected). But either way it has digested some of the gains of previous weeks and is capable of moving higher with the strong trend behind it.

One setup you will likely see discussed numerous places this upcoming week is the "Golden Cross". A Golden Cross occurs when the 50ma crosses over the 200ma. For the SPX it appears this will likely happen on Tuesday. Having the 50ma above the 200ma is commonly considered a bullish market condition – and generally it is. Much has been written about Golden Crosses over the past few years. Two blogs that have covered it nicely are MarketSci and Wooshedder's blog. Below are some links for anyone that would like to check out their research:

<http://marketsci.wordpress.com/2010/07/15/roundup-trading-the-golden-cross-2/>

<http://ibankcoin.com/woodshedderblog/2009/06/10/spx-golden-cross-coming-soon/>

I don't think the setup is worth spending an inordinate amount of time on – especially when so many others have done so as well. I didn't notice the trades listed anywhere else so I decided I would do that for anyone interested.

Buy SPX when 50ma crosses over 200ma.  
 Sell when 50ma crosses back below 200ma. \$100k/trade. 1961 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
01/04/61	Buy	\$58.36	13.13%	\$24,461.64
05/07/62	Sell	\$66.02		\$0.00
01/03/63	Buy	\$63.72	31.59%	\$41,656.95
07/22/65	Sell	\$83.85		\$0.00
09/20/65	Buy	\$90.08	1.09%	\$4,417.80
04/29/66	Sell	\$91.06		(\$3,030.30)
02/03/67	Buy	\$87.36	3.63%	\$11,703.12
02/27/68	Sell	\$90.53		(\$1,029.60)
05/20/68	Buy	\$96.45	2.01%	\$12,349.12
03/13/69	Sell	\$98.39		\$0.00
05/27/69	Buy	\$103.57	(7.09%)	\$0.00
06/23/69	Sell	\$96.23		(\$7,083.10)
10/21/70	Buy	\$83.66	17.32%	\$25,226.45
09/24/71	Sell	\$98.15		(\$1,039.65)
01/26/72	Buy	\$102.50	8.82%	\$17,296.50
04/18/73	Sell	\$111.54		\$0.00
03/07/75	Buy	\$84.30	21.58%	\$27,906.58
12/01/76	Sell	\$102.49		(\$4,684.70)
01/04/77	Buy	\$105.70	(4.56%)	\$0.00
03/03/77	Sell	\$100.88		(\$5,884.12)
05/22/78	Buy	\$99.08	(3.06%)	\$9,050.73
12/13/78	Sell	\$96.05		(\$7,506.96)
03/22/79	Buy	\$101.66	1.73%	\$18,244.48
04/22/80	Sell	\$103.42		(\$4,099.11)
06/18/80	Buy	\$116.25	10.65%	\$22,110.60
07/02/81	Sell	\$128.63		(\$2,700.40)
09/28/82	Buy	\$123.24	30.57%	\$40,436.46
02/03/84	Sell	\$160.91		(\$3,333.21)
09/12/84	Buy	\$164.67	43.78%	\$54,368.99
11/18/86	Sell	\$236.77		(\$2,822.55)
11/25/86	Buy	\$248.16	2.54%	\$36,067.44
11/05/87	Sell	\$254.47		(\$12,743.40)
06/28/88	Buy	\$272.31	20.69%	\$32,398.76
02/26/90	Sell	\$328.66		(\$5,791.26)
05/25/90	Buy	\$354.58	(8.80%)	\$4,286.40
09/07/90	Sell	\$323.39		(\$13,651.62)
02/15/91	Buy	\$369.06	19.91%	\$30,723.30
04/19/94	Sell	\$442.54		(\$1,857.60)
09/15/94	Buy	\$474.81	120.93%	\$150,311.70
09/29/98	Sell	\$1,049.00		(\$6,705.30)
12/08/98	Buy	\$1,181.38	15.99%	\$20,055.84
11/05/99	Sell	\$1,370.23		(\$3,738.00)
11/10/99	Buy	\$1,373.46	1.83%	\$12,917.52
10/30/00	Sell	\$1,398.65		(\$4,872.24)
05/14/03	Buy	\$939.28	16.60%	\$23,738.70
08/18/04	Sell	\$1,095.17		(\$2,886.38)
11/05/04	Buy	\$1,166.17	8.03%	\$13,645.05
07/19/06	Sell	\$1,259.81		(\$2,551.70)
09/12/06	Buy	\$1,313.12	13.05%	\$19,985.72
12/21/07	Sell	\$1,484.50		(\$165.68)
06/23/09	Buy	\$895.10	14.24%	\$36,041.70
07/02/10	Sell	\$1,022.58		(\$2,861.58)
10/22/10	Buy	\$1,183.08	(0.36%)	\$15,750.00
08/12/11	Sell	\$1,178.81		(\$6,849.36)

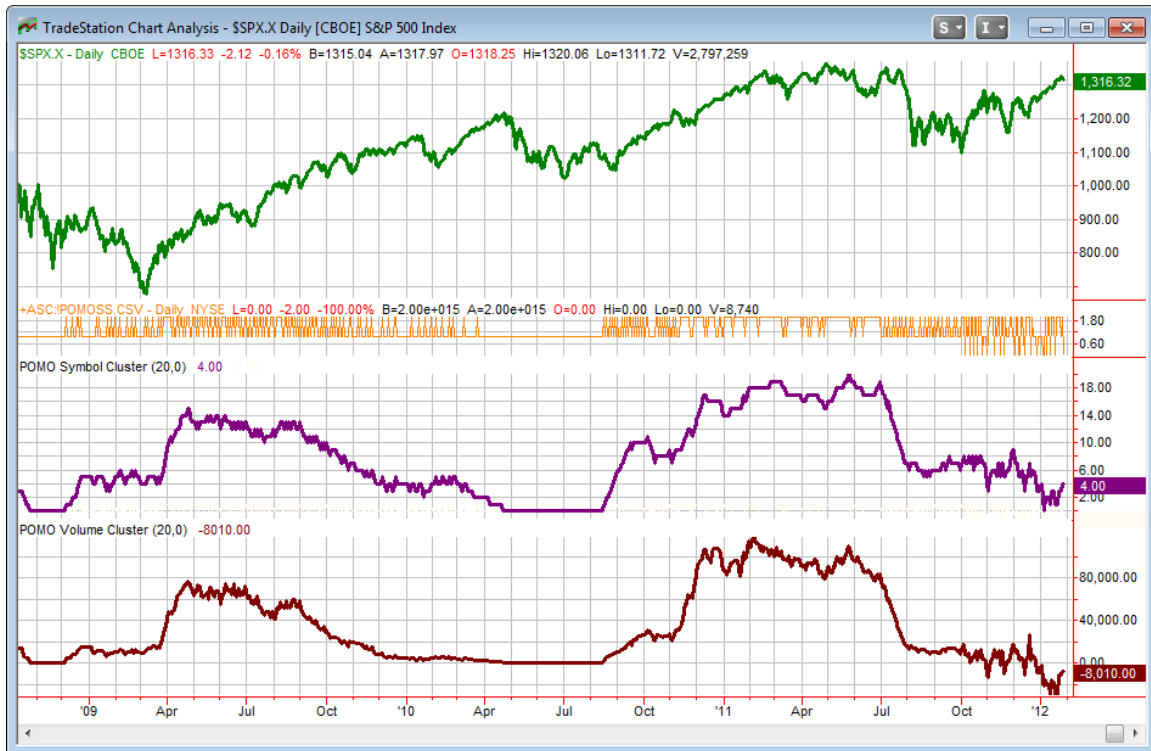
A few things really stand out here. First, the winning percentage is terrific with 22 winners and only 5 losers. Also with the winners substantially larger than the losers risk/reward is very good. The profit factor on these trades is about 18. Just as notable is the fact that the golden cross has done exceptionally well over the last 10-12 years while the market has struggled.

I don't view these crosses as an "actionable signal" from a trading standpoint, but they have been good enough over the years to keep in mind. Essentially, they suggest an uptrending market is a bullish thing, which is something many traders are aware of. As with everything, I'm more comfortable basing decisions on concepts like this when I see quantifiable evidence to support it. This simple study seems to be providing some nice evidence.

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 3<sup>rd</sup> POMO presentation linked below. (Not available for trial users.)*

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

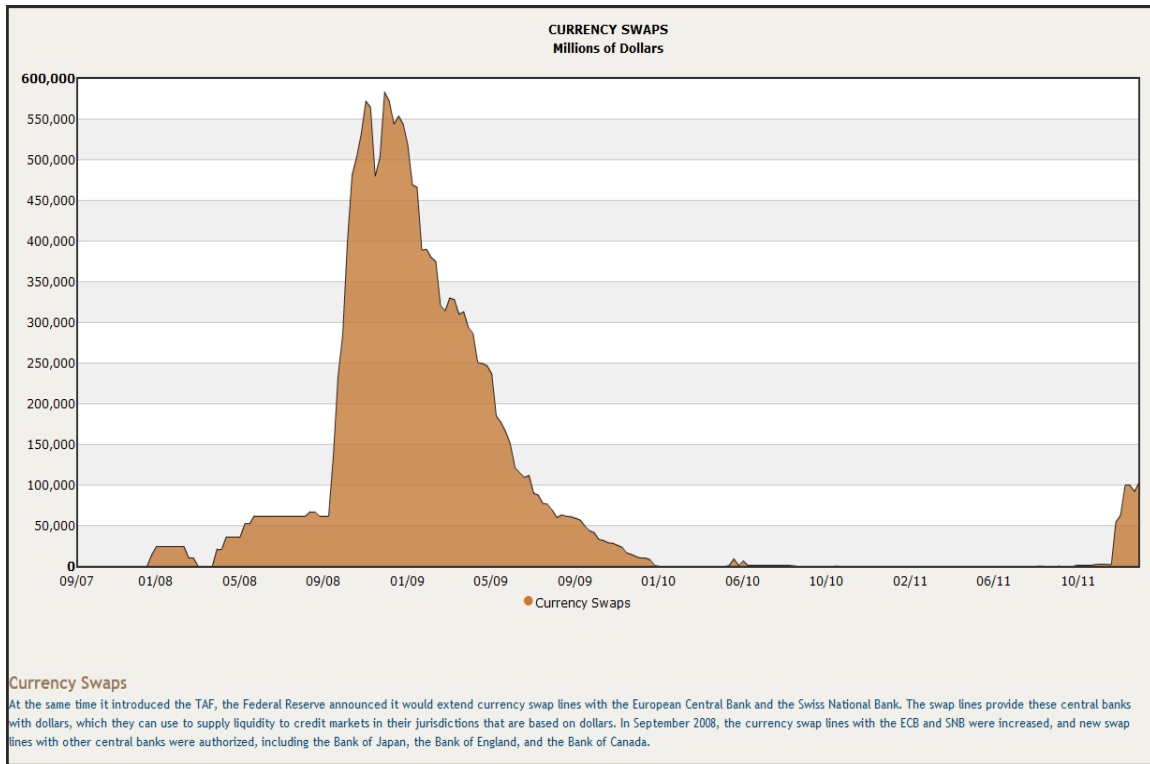


POMO numbers showed mild net gains this past week. The fed added about \$0.5 billion to the system. Some negative weeks are now coming off the back end of the intermediate-term POMO calculations so even though the net was small this week, the POMO indicators jumped up a bit. Still, the POMO volume remains negative over the last 20 days, and could serve as a possible drag on the market.

We are obviously seeing the first divergence in the intermediate-term POMO chart since about 2005. Despite the negative POMO volume recently the market has continued to rise. This could be a very good thing. The market has been addicted to liquidity in the last several years. It has consistently risen when the Fed has stimulated and consistently struggled when the Fed has tightened or sat idle. Seeing a time where the market (and the economy) can again stand on its own would be fantastic. But I am not seeing any signs of a booming economy at this point. So either the stock market is leading the economic turnaround, or the stock market is wrong, or there is something going on that we are not seeing in the POMO chart. Which brings me to the next chart.

An astute reader pointed out to me this chart from the Cleveland Fed's website. It shows the amount of currency swaps on the Fed's balance sheet. A link to the information is below for those that would like to explore further. (You may need to click on "currency swaps on the left hand side of the page to see this chart.)

[http://www.clevelandfed.org/research/data/credit\\_easing/index.cfm](http://www.clevelandfed.org/research/data/credit_easing/index.cfm)



What we see here is that since the emergency swap lines to Europe were announced at the end of November, the Fed has lent out about \$100 billion in swaps. Prior to this there had been almost no substantial swap transactions since late 2008. This is not like easing we have seen in the recent past where much of the liquidity went to US financial institutions. Instead it is Europe who is getting the easy money. There has been some stabilization over there which seems to have quelled some fears. Perhaps that is helping the market rise and perhaps even some of this money is making its way into the global (and US) stock markets to help boost prices.

For some further explanation on these swap transactions I will refer you to the Dec 16<sup>th</sup> speech by William Dudley, President of the New York Fed:

<http://www.newyorkfed.org/newsevents/speeches/2011/dud111216.html>

Here are a few paragraphs that I find most notable:

Banks headquartered outside the U.S., like banks that are headquartered here, make extensive use of dollars in their financing activities. In part, this is due to the fact that the U.S. dollar is the world's number one currency—a status that brings with it many benefits for our country. It is in the U.S. national interest to make sure that non-U.S. banks that are judged to be sound by their central bank are able to access the U.S. dollar funding they need in order to be able to continue to finance their U.S. dollar assets. If the access to dollar funding were severely impaired, this

could necessitate the abrupt, forced sales of dollar assets by these banks, which could seriously disrupt U.S. markets and adversely affect U.S. businesses, consumers and jobs.

One way we can help to support the availability of dollar funding is by engaging in currency swaps with other central banks. This has been used as a policy tool dating back to 1962. Recently, the Federal Open Market Committee decided to re-launch this tool, cooperating with five other central banks. Our intention is to create a credible backstop to—but not supplant—private markets. Banks with surplus dollars are more likely to lend to banks in need of dollars if they know that the borrowing bank will be able to obtain the dollars it needs to repay the loan, if necessary, from its central bank...

...In sum, I am hopeful that Europe can effectively address its current fiscal challenges. The Federal Reserve is actively and carefully assessing this situation and the potential impact on the U.S. economy. At this time, although I do not anticipate further efforts by the Federal Reserve to address the potential spillover effects of Europe on the United States, we will continue to monitor the situation closely.

So one possible explanation is that while it is not seen on the POMO chart, the global economy has been flooded with liquidity over the last 2 months, and this may be helping providing a wind at the market's back. This "hidden" form of easing bears watching and I'll likely refer back to it on occasion. So far I have not found a place to download raw data similar to the POMO data. Should any subscribers be aware of its availability I'd appreciate you pointing it out.

Monday and Tuesday are scheduled to see more POMO buying, but beyond that the schedule is not yet available. The next POMO schedule is set to be released on Tuesday and will cover February's anticipated POMO activity. Traders may use the below link to see the new schedule starting Tuesday afternoon.

[http://www.newyorkfed.org/markets/tot\\_operation\\_schedule.html](http://www.newyorkfed.org/markets/tot_operation_schedule.html)

So the intermediate-term still appears to be looking up. The SPX is in rally mode, a golden cross is about to occur, the Nasdaq is still in a leadership position, and there also appears to be strong upside momentum. Therefore, 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.*

***SPY – buy ¼ index position @ \$131.37 LIMIT ON CLOSE.*** There is some evidence suggest a short-term rise, and the market will be underperforming expectations if that rise does not come Monday. I'll look to buy at the close if the SPX closes below its' 10ma. Otherwise I will evaluate further on Monday night and likely look for entry on Tuesday if an Aggregator signal triggers.

## **Current Open Trade Ideas**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Price</b>	<b>% Gain/Loss</b>	<b>Stop</b>	<b>Notes</b>
DIA(s)	1/23/2012	\$126.96	\$126.45	0.40%		System -80514

*I will cover DIA on a close < \$126.37 as per the system -80514 rules.*

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