

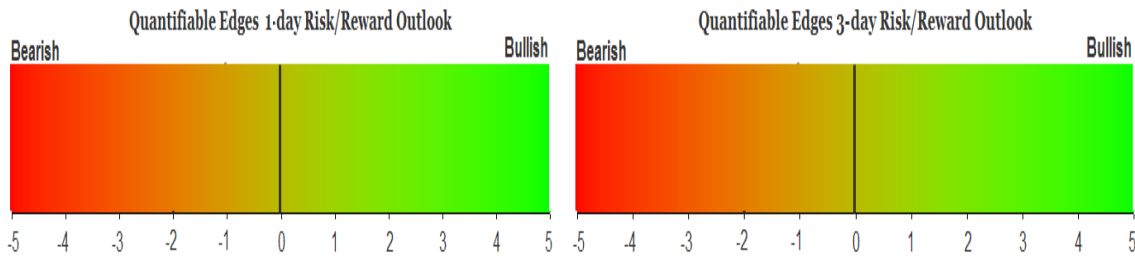
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 6, 2012

Volume 5 Issue 24

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- 2 of 3 days with 75% up issues combined with a 10-day high above the 200ma is a setup that has often been followed by more upside.
- The QE Buying Power Index is set to turn negative on Wednesday and Thursday this week for the only time in February.

## Short-term Outlook

### The Bottom Line

While expectations are still positive the market is now strongly overbought. I've stepped aside and am awaiting a better risk/reward setup to re-enter.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
February 6, 2012	Up Issues % > 75% 2 of 3. 10 high.	1-6 days	Bullish	2.60%
<b>Active - Long Term</b>				
February 6, 2012	Up Issues % > 75% 2 of 3. 10 high.	1-16 days	Bullish	4.70%
February 2, 2012	50-high then 5-day consolidation	1-10 days	Bullish	2.30%
February 1, 2012	Golden Cross	int term	Bullish	
January 31, 2012	SPY 1st close < 10ma in over 25 days	1-20 days	Bullish	4.70%
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/20 day high	int term	Bullish	
<b>Dropped Tonight</b>				
<b>January 31, 2012</b>	<b>SPY 1st close &lt; 10ma in over 25 days</b>	<b>1-4 days</b>	<b>Bullish</b>	<b>1.80%</b>
<b>February 2, 2012</b>	<b>50-high then 5-day consolidation</b>	<b>1-3 days</b>	<b>Bullish</b>	<b>1.10%</b>
<b>February 1, 2012</b>	<b>Selloff at month end</b>	<b>1-5 days</b>	<b>Bullish</b>	<b>2.35%</b>
<b>January 31, 2012</b>	<b>SPY 3-day pullback. Today is Mon</b>	<b>1-4 days</b>	<b>Bullish</b>	<b>2.30%</b>

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

## The Evidence

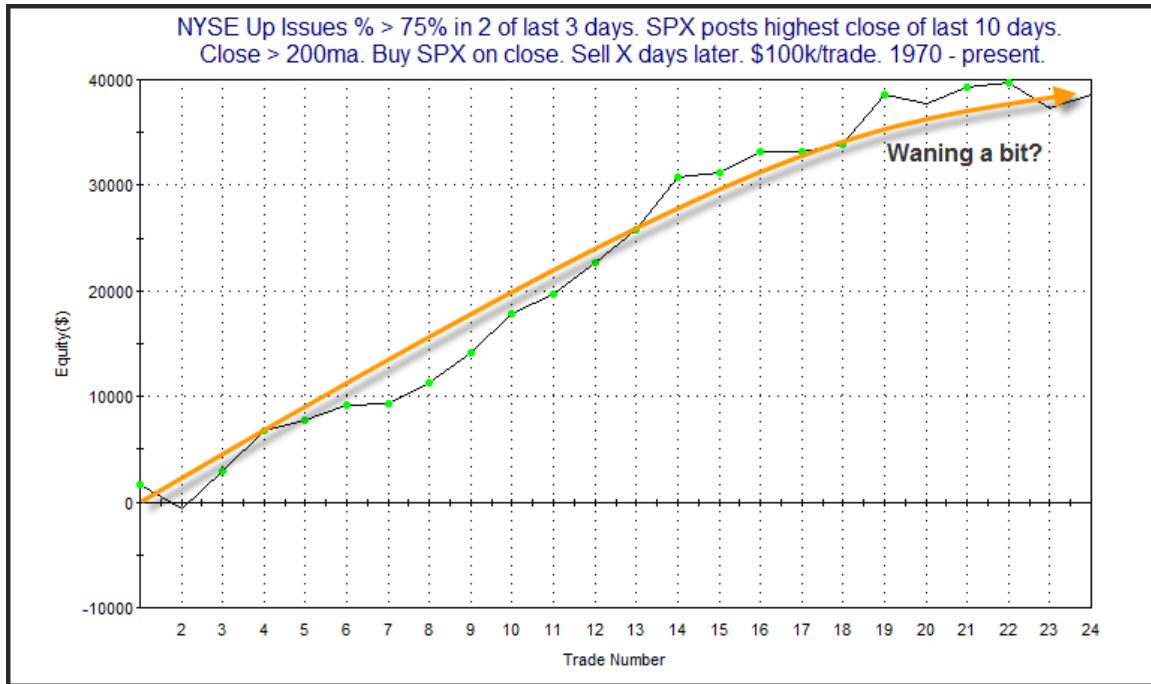
Friday's employment report was received well and the market rallied to new intermediate-term highs. It opened strong and finished stronger. The SPX gained 1.5%, the Nasdaq rose 1.6% and the Russell 2000 rallied 2.2%. Breadth was very strong as the NYSE Up Issues % came in at 78% and the Up Volume % was 86%. Total NYSE volume rose above the level of the last 2 days.

Before we even consider looking at new studies I will note that Friday's big pop was strong enough that it saw all 4 studies from the Short-Term Active List reach their targets. All 4 were therefore removed from the list. Though some still had time left, the market has now moved strongly enough that any further gains are likely not the result of the setups seen in those studies.

The most impressive part of the move over the last 3 days has been the breadth. Both Friday and Wednesday saw over ¾ of the issues on the NYSE rise on the day. When this has happened in the past and it was accompanied by both a 10-day high and a close above the 200ma then results going forward have been strongly bullish. This was last shown in the 7/22/11 subscriber letter. I have updated the study below.

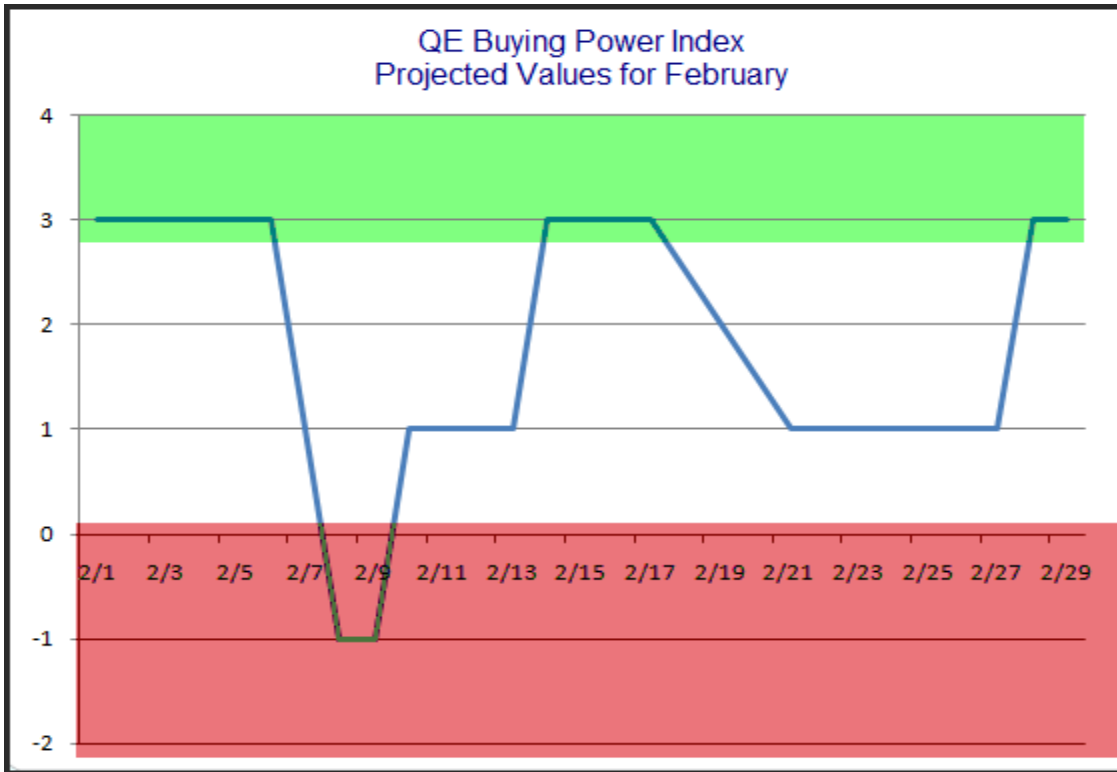
NYSE Up Issues % > 75% in 2 of last 3 days. SPX posts highest close of last 10 days. Close > 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1970 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
20	66,645.28	21	17	4	80.95	4,838.87	10,448.44	-3,903.86	-9,695.84	1.24	5.27	3,173.58
19	66,771.74	21	18	3	85.71	4,491.55	10,910.56	-4,692.03	-9,455.60	0.96	5.74	3,179.61
18	66,566.66	21	19	2	90.48	4,079.25	8,727.84	-5,469.58	-7,434.35	0.75	7.09	3,169.84
17	67,766.95	21	19	2	90.48	4,035.61	9,187.20	-4,454.81	-7,053.97	0.91	8.61	3,227.00
16	68,193.59	21	19	2	90.48	3,973.78	9,539.88	-3,654.10	-5,308.38	1.09	10.33	3,247.31
15	59,789.75	21	17	4	80.95	4,030.77	8,941.56	-2,183.32	-5,271.42	1.85	7.85	2,847.13
14	56,949.43	21	19	2	90.48	3,358.08	7,807.79	-3,427.00	-3,671.36	0.98	9.31	2,711.88
13	55,947.40	22	18	4	81.82	3,419.59	8,597.16	-1,401.31	-2,794.60	2.44	10.98	2,543.06
12	52,896.14	23	18	5	78.26	3,399.72	7,623.04	-1,659.75	-2,526.37	2.05	7.37	2,299.83
11	54,837.95	23	19	4	82.61	3,179.26	7,783.28	-1,391.99	-2,160.00	2.28	10.85	2,384.26
10	47,678.75	23	19	4	82.61	2,971.89	7,954.00	-2,196.78	-3,456.53	1.35	6.43	2,072.99
9	45,889.87	23	18	5	78.26	3,016.86	8,085.92	-1,682.73	-4,272.73	1.79	6.45	1,995.21
8	42,744.97	23	19	4	82.61	2,433.26	6,037.28	-871.76	-2,700.00	2.79	13.26	1,858.48
7	40,458.95	23	18	5	78.26	2,516.81	6,145.92	-968.73	-2,192.40	2.60	9.35	1,759.08
6	38,574.31	24	21	3	87.50	2,100.95	5,002.50	-1,848.55	-2,414.72	1.14	7.96	1,607.26
5	31,721.17	25	19	6	76.00	1,952.94	4,482.50	-897.46	-1,804.88	2.18	6.89	1,268.85
4	20,364.49	26	19	7	73.08	1,506.14	6,138.16	-1,178.89	-3,595.13	1.28	3.47	783.25
3	13,016.56	26	18	8	69.23	1,249.53	4,376.64	-1,184.38	-5,105.87	1.06	2.37	500.64
2	8,420.54	29	18	11	62.07	1,030.34	4,399.92	-920.50	-3,149.67	1.12	1.83	290.36
1	7,772.64	31	20	11	64.52	643.24	1,848.00	-462.93	-1,564.34	1.39	2.53	250.73

Early results are strong and after a little over 3 weeks results are even stronger. Below I have produced the profit curve assuming a 6-day holding period.



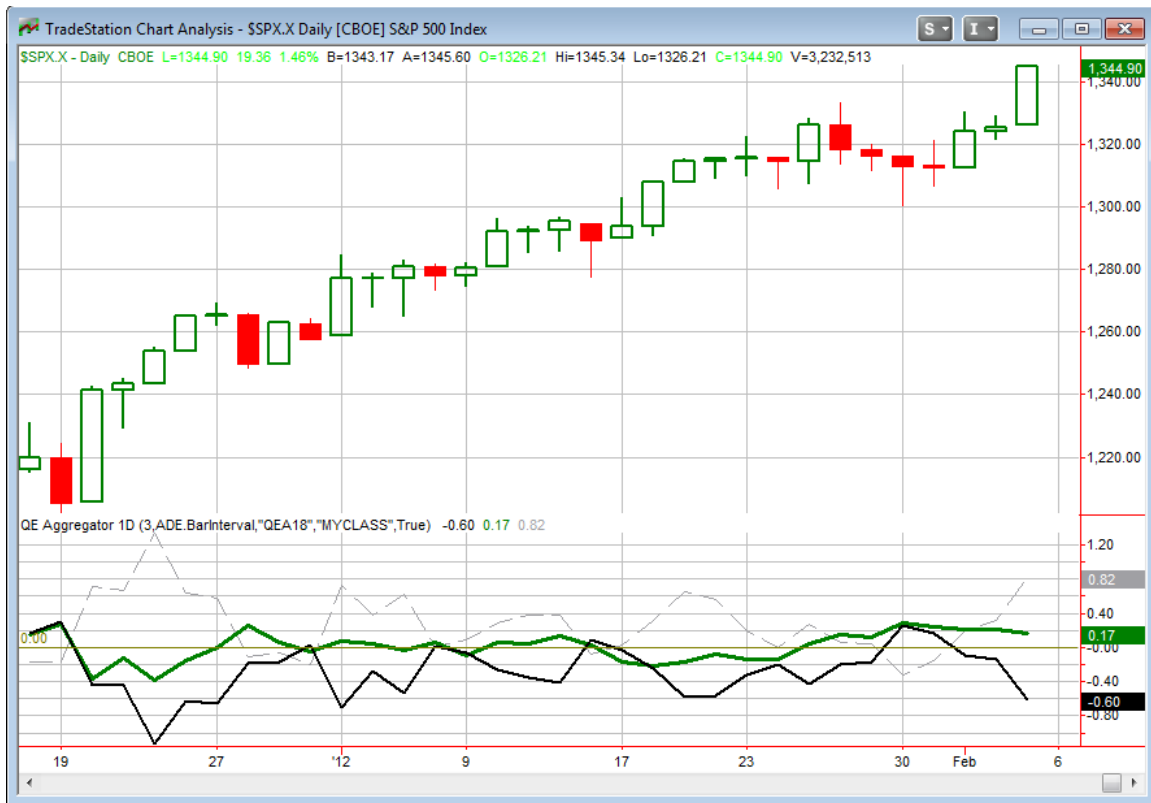
There recent instances haven't been as strong, which bears watching. Still, the study certainly seems worthy of consideration and I have included it on both the short and intermediate-term active lists.

While I typically discuss the POMO edges in the intermediate-term section, I thought I would discuss the QE Buying Power Index here, since it has correlated so well with short-term market swings. One thing I love about the QE Buying Power Index as a tool is that you can calculate it ahead of time. The Fed published their February POMO schedule on Tuesday and assuming they buy and sell on the days they have indicated (and they seem to do so on a reliable basis), the QE Buying Power Index will move up and down throughout the month as shown below.



To make it easy to read, values in green indicate substantial buying power and a favorable environment for buying pullbacks. Values in red show 0 or negative QE buying power and a favorable environment for shorting rallies. There won't be many chances for the QE Buying Power Swing System to get short this month, but if the market is overbought on Wednesday or Thursday of this upcoming week, then that might be a favorable opportunity according to the QE Buying Power Index.

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



Tonight's bullish study helped to keep the green Aggregator line positive. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line is now strongly 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 considerably 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 before the bell.

Based on the current active studies, expectations are scheduled to remain positive on Monday. This could certainly change if bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,333.68 on Monday. This means the SPX will need to drop about 0.8% in order to turn the Differential Line positive.

While expectations remain positive, the market has been overbought for a few days now. And with Friday's big up day it is now strongly overbought. Under conditions such as this I don't see much point in pushing my luck with long positions, so I took profits before the close and am now basically neutral. Strongly overbought just isn't a setup where risk/reward for long trades is very good. Risks are elevated with technical support now far below and I would rather wait for a better opportunity before taking on exposure

again. If we get a pullback in the next couple of days then I may jump back in on the long side. But if the market continues to rally while the QE Buying Power Index dips into negative territory on Wednesday and Thursday, then a short setup may trigger. Either way, sometime in the next few days I suspect we will see a better entry point for a trade than we have now.

**Intermediate-term Outlook (2 weeks – 2 months)– updated 2/6 – bullish**

This past week saw some positive action and some very positive studies emerge. The SPX is again at intermediate-term highs and the trend is clearly up. So let’s review some of the studies with apparent bullish intermediate-term implications from this past week.

On Monday the SPY closed below its 10ma for the 1<sup>st</sup> time in over 25 days. That was a very persistent move prior to the dip and it triggered the study below which was seen in the 1/31 letter.

After closing above the 10ma for at least 25 days in a row SPY closes below it today. Buy on close. Sell X days later. \$100k/trade. 1993 - 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
20	27,880.19	7	7	0	100.00	3,982.88	7,915.86	0.00	0.00	100.00	100.00	3,982.88
19	27,835.45	7	7	0	100.00	3,976.49	6,866.19	0.00	0.00	100.00	100.00	3,976.49
18	23,064.36	7	7	0	100.00	3,294.91	5,903.19	0.00	0.00	100.00	100.00	3,294.91
17	22,252.87	7	7	0	100.00	3,178.98	5,537.25	0.00	0.00	100.00	100.00	3,178.98
16	23,935.96	7	7	0	100.00	3,419.42	5,662.44	0.00	0.00	100.00	100.00	3,419.42
15	23,827.27	7	7	0	100.00	3,403.90	6,047.64	0.00	0.00	100.00	100.00	3,403.90
14	24,093.64	7	7	0	100.00	3,441.95	6,115.05	0.00	0.00	100.00	100.00	3,441.95
13	26,203.22	7	7	0	100.00	3,743.32	6,500.25	0.00	0.00	100.00	100.00	3,743.32
12	23,657.50	7	7	0	100.00	3,379.64	5,604.66	0.00	0.00	100.00	100.00	3,379.64
11	22,113.82	7	7	0	100.00	3,159.12	5,845.41	0.00	0.00	100.00	100.00	3,159.12
10	18,989.71	7	7	0	100.00	2,712.82	5,325.39	0.00	0.00	100.00	100.00	2,712.82
9	16,811.66	7	7	0	100.00	2,401.67	4,882.41	0.00	0.00	100.00	100.00	2,401.67
8	14,153.25	7	7	0	100.00	2,021.89	4,574.25	0.00	0.00	100.00	100.00	2,021.89
7	10,927.28	7	7	0	100.00	1,561.04	4,304.61	0.00	0.00	100.00	100.00	1,561.04
6	8,323.08	7	5	2	71.43	1,754.29	3,158.64	-224.19	-280.80	7.83	19.56	1,189.01
5	10,348.47	7	6	1	85.71	1,801.18	3,466.80	-458.64	-458.64	3.93	23.56	1,478.35
4	10,195.75	7	7	0	100.00	1,456.54	3,158.64	0.00	0.00	100.00	100.00	1,456.54
3	7,406.49	7	7	0	100.00	1,058.07	2,744.55	0.00	0.00	100.00	100.00	1,058.07
2	4,012.62	7	6	1	85.71	707.70	1,656.36	-233.60	-233.60	3.03	18.18	573.23
1	3,557.40	7	5	2	71.43	742.91	1,974.15	-78.57	-98.75	9.45	23.64	508.20

Strong and persistent upside movement as shown in December and January hasn't just ended and lead to an immediate correction. The 1st dip has always been just that – a dip. New highs were always made in short order (and they have been already this time as well).

On Tuesday the SPX completed its Golden Cross formation. I discussed this in detail in last week's intermediate-term update, so I won't rehash it again here. The bottom line was that when the 50ma has historically been above the 200ma that has generally suggested a bullish intermediate-term environment.

Wednesday marked the 5<sup>th</sup> day of consolidation after the SPX had previously made a 50-day high. This triggered the study below which was shown in the 2/2 letter.

After closing at a 50-day high SPY closes between the high and the low of the new high day for the next 5 days. Buy on close. Sell X days later. \$100k/trade. 1993 - 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	26,614.43	19	16	3	84.21	2,031.79	6,287.04	-1,964.71	-5,182.56	1.03	5.52	1,400.76
9	22,432.85	19	17	2	89.47	1,489.10	6,322.56	-1,440.95	-2,251.44	1.03	8.78	1,180.68
8	20,761.25	19	16	3	84.21	1,575.12	6,287.04	-1,480.21	-2,060.28	1.06	5.68	1,092.70
7	14,302.77	19	14	5	73.68	1,561.09	5,339.84	-1,510.50	-3,472.29	1.03	2.89	752.78
6	5,000.09	19	12	7	63.16	1,199.11	3,362.56	-1,341.32	-2,992.38	0.89	1.53	263.16
5	7,493.00	19	10	9	52.63	1,430.76	3,031.04	-757.17	-2,425.20	1.89	2.10	394.37
4	10,009.51	19	12	7	63.16	1,203.47	2,806.08	-633.16	-1,541.60	1.90	3.26	526.82
3	9,294.74	19	14	5	73.68	1,007.03	2,296.96	-960.73	-2,368.80	1.05	2.93	489.20
2	3,120.18	19	12	7	63.16	720.12	1,817.10	-788.75	-1,627.93	0.91	1.57	164.22
1	98.92	19	10	9	52.63	574.80	1,433.49	-627.68	-1,100.97	0.92	1.02	5.21

**- 16 of 19 instances (84%) closed above the entry price at some point in the next 3 days.**  
**- All instances closed above the entry price at some point in the next 2 weeks.**  
**- 16 of 19 instances also posted a new 50-day high at some point in the next 2 weeks.**

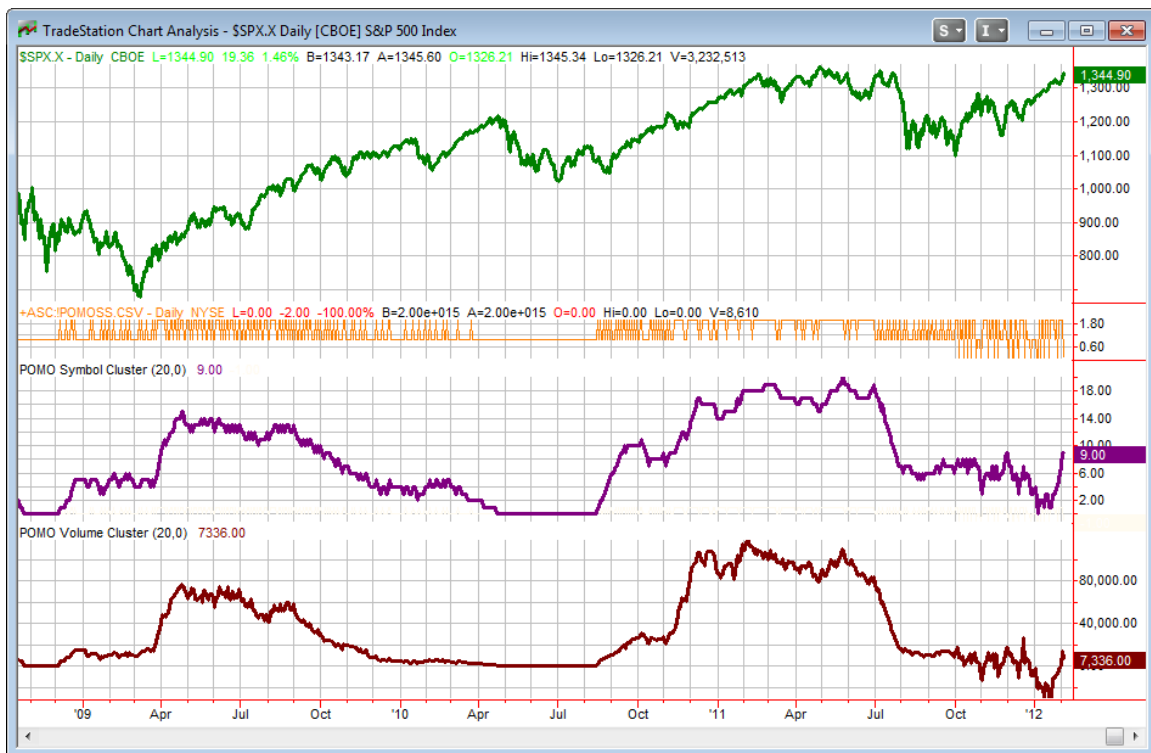
This study suggested both a short-term (1-3 day) edge and an intermediate-term edge (up to 2 weeks). The short-term edge panned out and it is on track for the intermediate-term.

Lastly, the breadth study from the short-term section above also suggests bullish intermediate-term implications. Four new and diverse intermediate-term studies this week seems to be an encouraging sign.

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 solid gains this past week. The Fed added about \$5 billion to the system. This combined with a negative week coming off the back end caused a sizable jump in the intermediate-term POMO indicators.

While this past week saw a nice rise in our indicators, the POMO liquidity pump is still just dripping compared to the periods of QE1 and QE2. And for the 1<sup>st</sup> time since at least 2005 the market appears to be rallying without help from POMO. I explored swap lines as one possible explanation last week. Since then swaps have seen neither an expansion nor a contraction, but I will continue to keep an eye on them. In any case, my interpretation of the POMO chart is that on an intermediate-term basis it does not appear to be lending much help. But the short-term impact still appears considerable and traders may want to keep in mind the QE Buying Power chart from the short-term section above.

So the intermediate-term still appears to be looking up. The SPX is in rally mode, we got a Golden Cross this past week, and are seeing support from studies based on momentum, trend, and breadth. And the Nasdaq is still in a leadership position. 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.*

*None tonight. .*

## **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>
<i>SPY(1/4)</i>	<i>1/30/2012</i>	<i>\$131.37</i>	<i>\$133.52</i>	<i>1.63%</i>		<i>average exit price shown</i>

*The 2<sup>nd</sup> half of the SPY position was exited on the close as indicated in the intraday update sent to subscribers Friday morning.*

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