

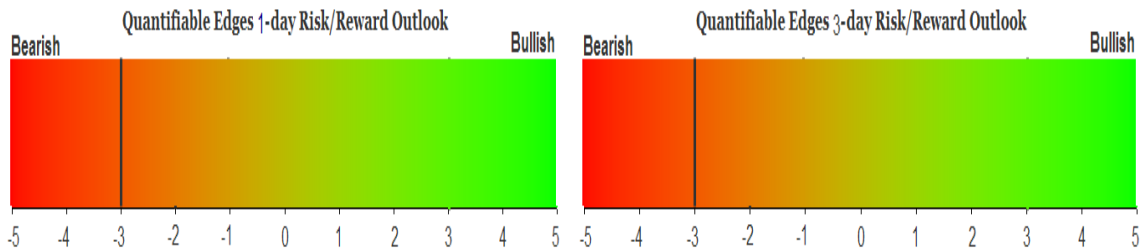
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 21, 2012

Volume 5 Issue 34

## Market Overview



## Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Short	100% Short SPY	Flat	Long

## Tonight's Research Points

- Op-ex week gains of 1%-2% are generally followed by a pullback.
- SPY making back to back 50-day highs on decreasing volume has been a bad short-term omen historically.
- The low VIX:VXV ratio at a 50-day SPX high suggests downside risk outsizes upside reward for the following day.

## *Short-term Outlook*

### *The Bottom Line*

The market is strongly overbought and short-term evidence favors the bears. I have some short exposure to try and take advantage of the apparent downside edge.

*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 21, 2012	SPX gains 1%-2% op-ex week. SPX > 200	1-5 days	Bearish	
February 21, 2012	SPY 2 50-highs on lower volume	1-2 days	Bearish	
February 21, 2012	SPX 50 high. VIX:VXV < 0.85	1 day	Bearish	
February 17, 2012	Top 10% of 10-day range before opex	1-4 days	Bearish	
February 15, 2012	Unfill gap up. 20-high. Unfill gap dn.	1-6 days	Bearish	-1.40%
February 14, 2012	20-high. Gap down. Gap up.	1-6 days	Bearish	-1.90%
February 13, 2012	60-day low SPY range. Close > 200ma	1-6 days	Bearish	-2.15%
<b>Active - Long Term</b>				
February 6, 2012	Up Issues % > 75% 2 of 3. 10 high.	1-16 days	Bullish	4.70%
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/20day high	int term	Bullish	
<b>Dropped Tonight</b>				
February 17, 2012	Friday before President's Day	1 day	Bearish	

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

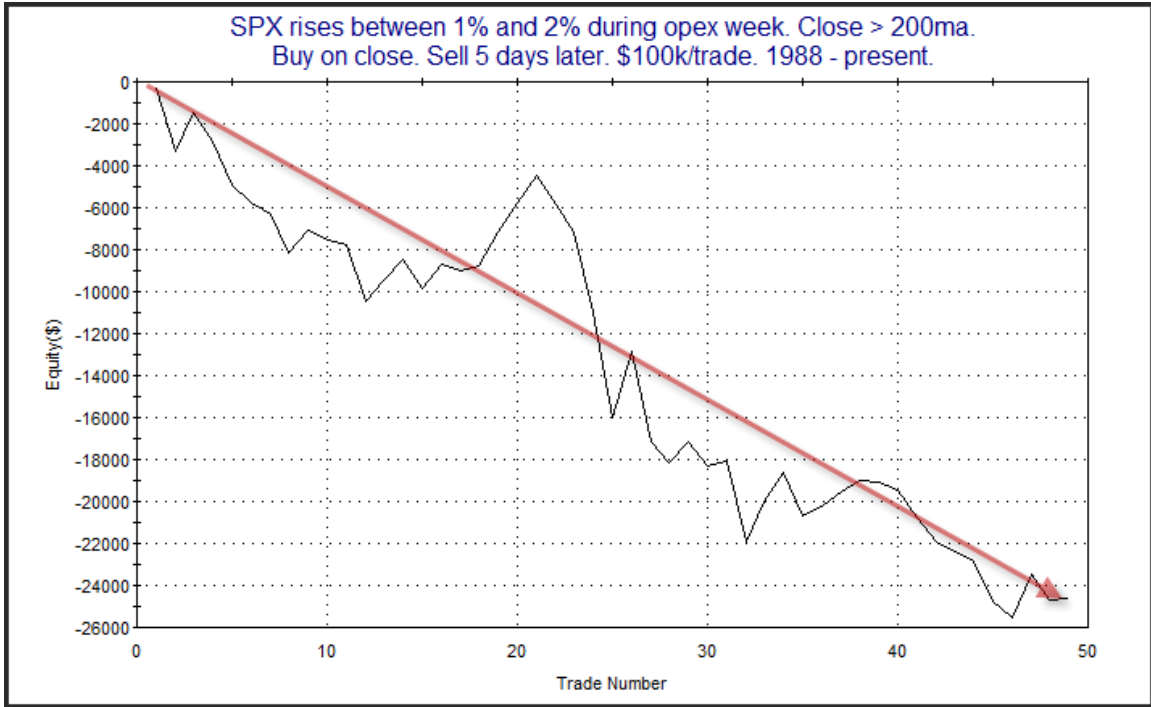
**The Evidence**

Options expiration caused volume to come in a little higher than it has lately but action was still fairly quiet going in to the President's Day weekend. Indices finished mixed. The SPX gained 0.2% but the Nasdaq lost 0.3% and the Russell 2000 fell 0.1%. Breadth was positive as the NYSE Up Issues % came in at 58% and the Up Volume % was 56%. Total NYSE volume was high but helped by op-ex..

The strong op-ex week performance triggered the study below from the 2/22/11 subscriber letter. It examined times when the SPX was in a long-term uptrend and op-ex week performance was solid with a gain between 1%-2%. I have updated the results below.

SPX rises between 1% and 2% during opex week. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1988 - 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	-24,584.91	49	19	30	38.78	1,155.97	3,146.64	-1,551.61	-4,961.56	0.75	0.47	-501.73
4	-18,632.87	49	17	32	34.69	1,022.81	3,212.16	-1,125.64	-4,046.70	0.91	0.48	-380.26
3	-6,108.88	49	24	25	48.98	807.82	3,403.68	-1,019.87	-2,765.00	0.79	0.76	-124.67
2	-8,383.92	49	24	25	48.98	574.65	1,590.30	-887.02	-2,917.60	0.65	0.62	-171.10
1	-4,351.22	49	19	30	38.78	570.28	1,739.10	-506.22	-2,470.65	1.13	0.71	-88.80

The results table suggests a short-term downside edge. Below is the profit curve assuming a 5-day holding period.



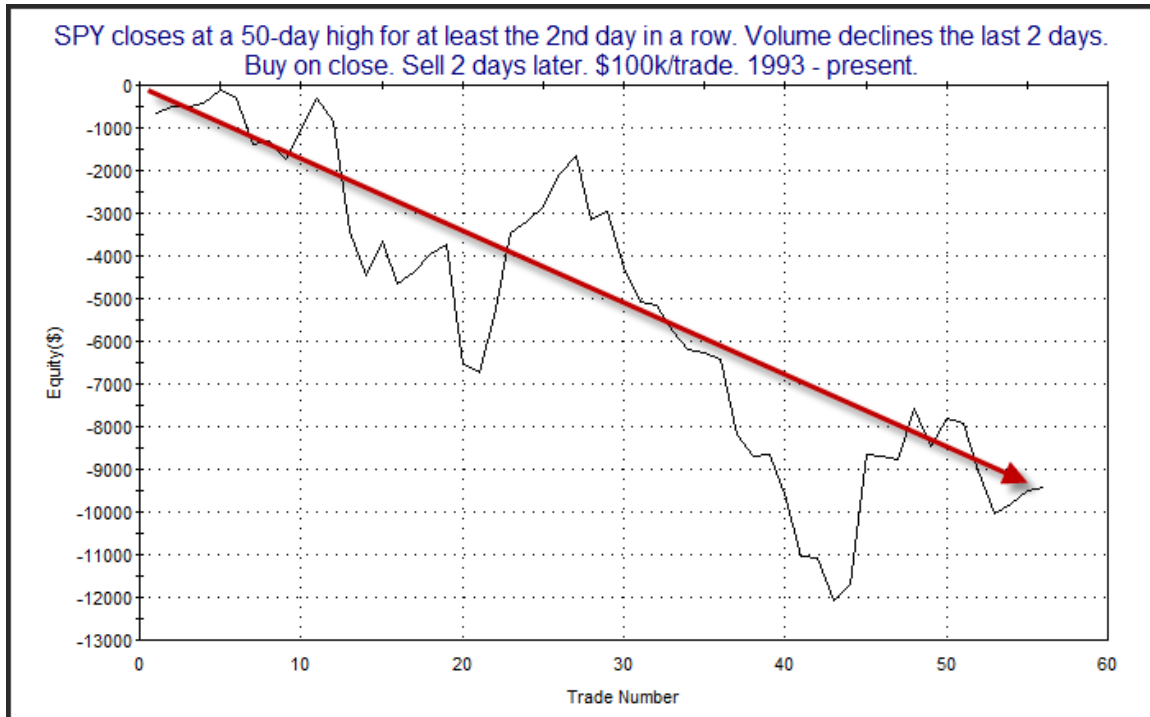
There was definitely a big bump for a few trades in the middle of the chart, but that was quickly righted. Overall the equity curve appears suitable enough to confirm the downside edge suggested by the stats table.

While SPY was making new highs the last couple of days, SPY volume declined. This triggered the study below, which was last seen in the 4/29/11 subscriber letter. I have updated the results.

SPY closes at a 50-day high for at least the 2nd day in a row. Volume declines the last 2 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
5	-11,078.99	55	25	29	45.45	986.33	5,787.33	-1,232.32	-4,272.30	0.80	0.69	-201.44
4	-9,212.79	56	26	30	46.43	834.27	3,376.89	-1,030.13	-4,081.95	0.81	0.70	-164.51
3	-9,041.35	56	26	30	46.43	804.29	4,832.25	-998.43	-3,240.00	0.81	0.70	-161.45
2	-9,416.23	56	25	31	44.64	599.74	3,047.16	-787.41	-2,827.05	0.76	0.61	-168.15
1	-5,670.99	62	19	42	30.65	627.85	3,399.63	-419.05	-1,745.63	1.50	0.68	-91.47

The stats here appear to suggest a moderate downside edge over the next 1-2 days. Below is an equity curve using a 2-day exit strategy.



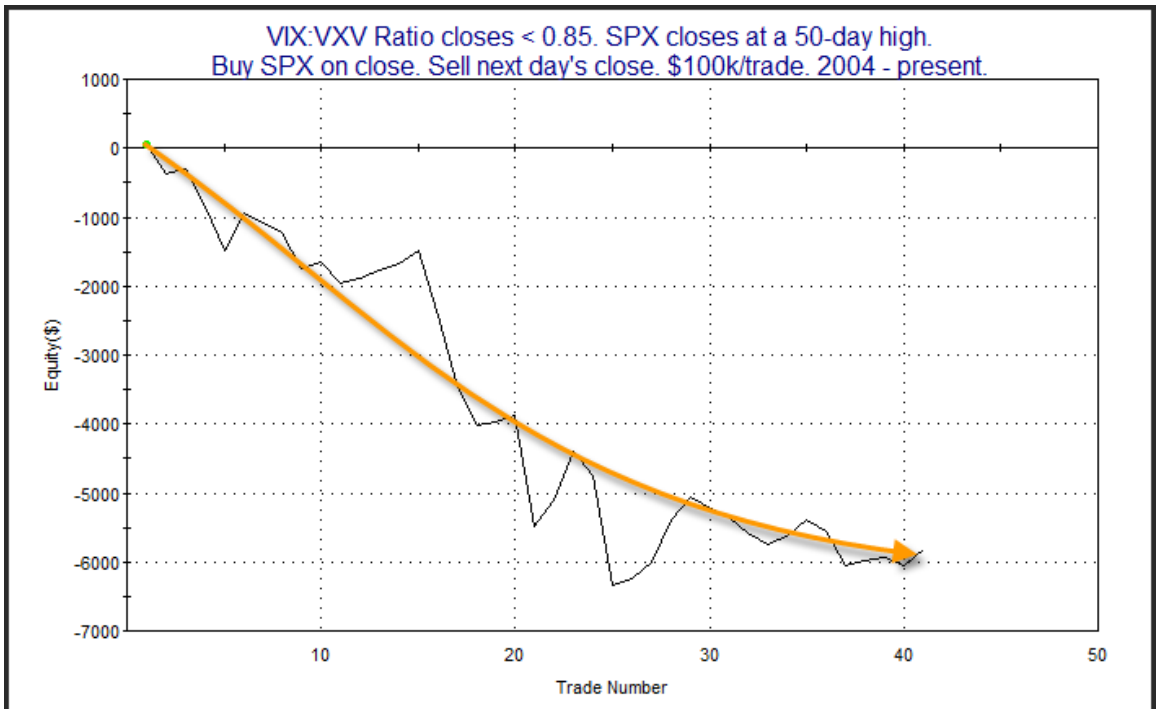
Definitely choppy but the series of lower highs and lower lows suggests a downtrend intact.

Another study identified by the Quantifinder examined instances of the SPX closing at a 50-day high while the VIX:VXV ratio was below 0.85. It showed a moderate 1-day downside edge. It was last seen in the 2/17/11 letter. I have updated the results again below (but kept the comments the same).

VIX:VXV Ratio closes < 0.85. SPX closes at a 50-day high.  
 Buy SPX on close. Sell next day's close. \$100k/trade. 2004 - present.

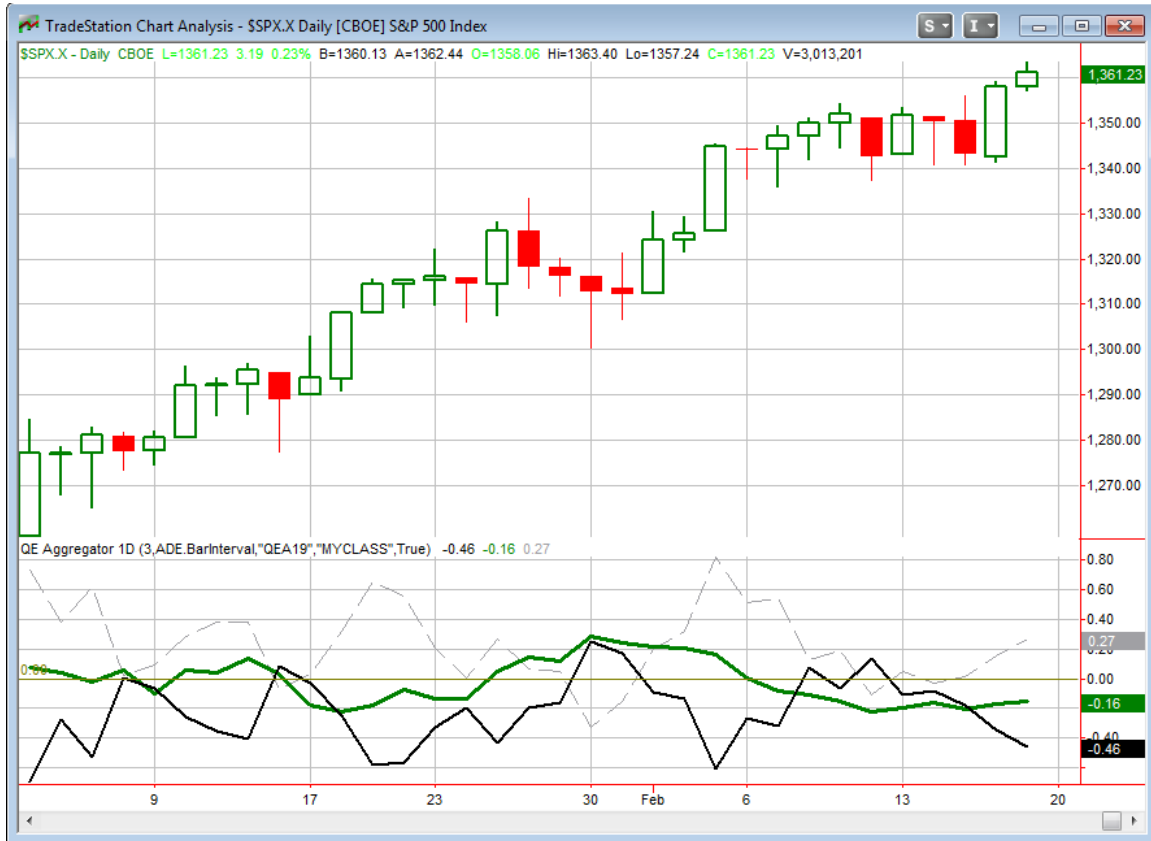
TradeStation Performance Summary <span style="float: right;">Collapse ^</span>			
All Trades			
Total Net Profit	(\$5,810.84)	Profit Factor	0.44
Gross Profit	\$4,493.36	Gross Loss	(\$10,304.20)
Total Number of Trades	41	Percent Profitable	51.22%
Winning Trades	21	Losing Trades	20
Even Trades	0		
Avg. Trade Net Profit	(\$141.73)	Ratio Avg. Win:Avg. Loss	0.42
Avg. Winning Trade	\$213.97	Avg. Losing Trade	(\$515.21)
Largest Winning Trade	\$708.05	Largest Losing Trade	(\$1,602.28)

The odds are 50/50 but the losers have been more than twice the size of the winners. This suggests the complacency we are seeing at these high levels is more likely to lead to a big down day than be followed by a big up day. To see how the edge has played out over time I have posted the profit curve below.



The equity curve seems to have flattened out a bit lately. I noted last time that I was going to keep an eye on this one, and I will continue to do so. For now I find it compelling enough to keep under consideration.

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



With tonight's bearish studies factored in the green Aggregator line is again squarely negative. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the black Differential Line is now well below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are bearish and the SPX is strongly overbought versus recent expectations. This is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close below 0. This caused the Aggregator System to remain short at the close. This was indicated on the Systems page before the bell.

Still without any short-term bullish evidence, expectations are scheduled to remain negative on Tuesday. This could change if very strong bullish evidence emerges. Meanwhile, the Differential Pivot will be 1,335.30 on Friday. This is 1.9% below Friday's close. The SPX has not had a drop this large in a long time. So it will likely take a couple of days of selling to turn the Differential Line negative.

There appears to be a short-side side edge and the market is long overdue a bit of a pullback. I have a small amount of short index exposure. I considered adding to it but with the trend and my intermediate-term outlook both still bullish, timing short trades is tricky and possibly dangerous. So I'll keep it small. More aggressive traders could certainly consider taking on a bit more short exposure – especially if they have some long positions which could use hedging.

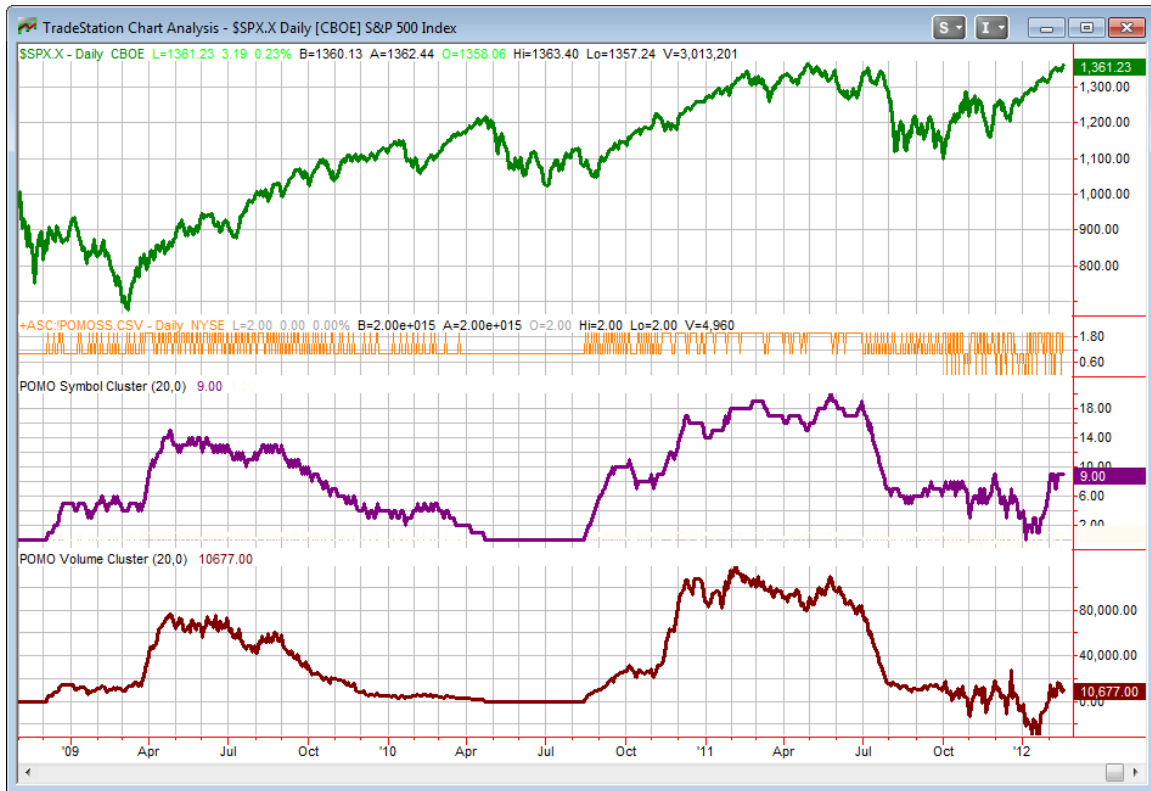
***Intermediate-term Outlook (2 weeks – 2 months)– updated 2/21 – bullish***

This past week saw the market post some solid gains and hit new highs. With new highs being reached on Friday the trend clearly remains up. And though the market looks susceptible to a short-term pullback there still appears to be ample evidence suggesting more upside over the intermediate-term. No new intermediate-term studies emerged in the last few days. The Active List here remains populated with studies seen in previous weeks.

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 were strong this past week. There were 4 days of buying and 1 day of selling and the net over the week was about \$5 billion in buying. This kept the POMO indicators fairly flat as a similar week fell off the back end of the equations.

Thus upcoming week is expected to see strong POMO selling. There are 2 small buying days and 2 large selling days schedule that will results in a net sale of over \$14 billion in securities. This could have a negative short-term impact on the market. While the QE Buying Power Index is scheduled to post moderate values of “+1” all week, the strong selling days will actually mean negative volume. If there is an opportune time for the market to pull back with all the bearish studies already on board, this upcoming week would seem to be it.

So the intermediate-term still appears to be looking up. The SPX is in rally mode. We are still seeing studies related to momentum, trend, breadth, and Nasdaq leadership all point higher. 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**

*FCX – 1/3 position @ \$42.40 limit (\$42.17 fill)*

*New*

*GILD – buy 1/3 position @ \$47.00*

### **Catapult for ETF's Trades**

*None*

### **Broad Market Large Cap CBI – 2(FCX, GILD)**

### **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.*

***GILD – buy 1/3 catapult position @ \$47.00 limit..** This is a Catapult trade idea from above.*

### **Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
FCX(1/3)	2/16/2012	\$42.17	\$43.04	2.06%	\$42.25	Catapult
SPY(1/4)(s)	2/17/2012	\$136.52	\$136.41	0.08%		Aggregator

*I will not be in the office at all on Tuesday. The estimated targets for FCX are a close  $\geq$  \$44.51 or a high  $\geq$  \$45.12. If either of these are hit FCX will be exited at the open on Wednesday.*

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