

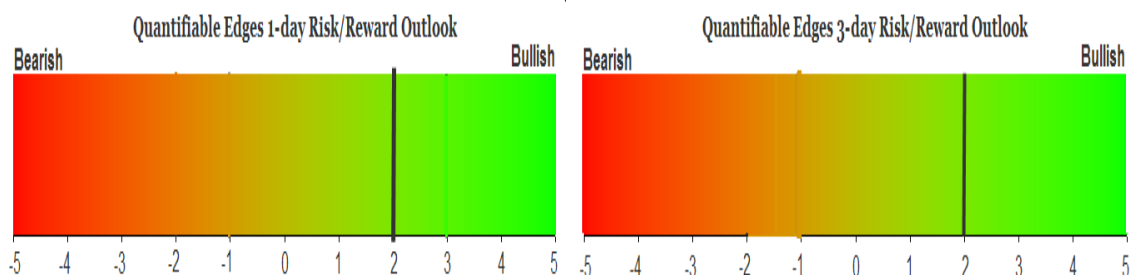
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 26, 2012

Volume 5 Issue 58

Market Overview



Signals Overview

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

Tonight's Research Points

- Mild movement the last few days has done little to suggest strong edges. Overall evidence is still pointing higher.

Short-term Outlook

The Bottom Line

Evidence remains bullish and the SPX is still oversold. This suggests an upside edge. I'm partially long and looking to take advantage of the bullish edge.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
March 23, 2012	3-day pullback from 50-high	1-6 days	Bullish	2.30%
March 19, 2012	SPX > Upper Bollinger 4 days	1-8 days	Bullish	1.90%
Active - Long Term				
March 15, 2012	5+ up to 50-high then dip	1-10 days	Bullish	2.00%
March 14, 2012	SPX & TNX hit 50-day highs	1-50 days	Bearish	
March 14, 2012	50-day high on strong breadth	1-50 days	Bullish	8.00%
March 5, 2012	Negative breadth divergences	int term	Bearish	
February 1, 2012	Golden Cross	int term	Bullish	
January 17, 2012	Nasdaq leading SPX	int term	Bullish	
December 5, 2011	POMO activity flat to negative	int term	Bearish	
Dropped Tonight				
March 14, 2012	100-day high on Fed Day	1-8 days	Bullish	2.00%

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

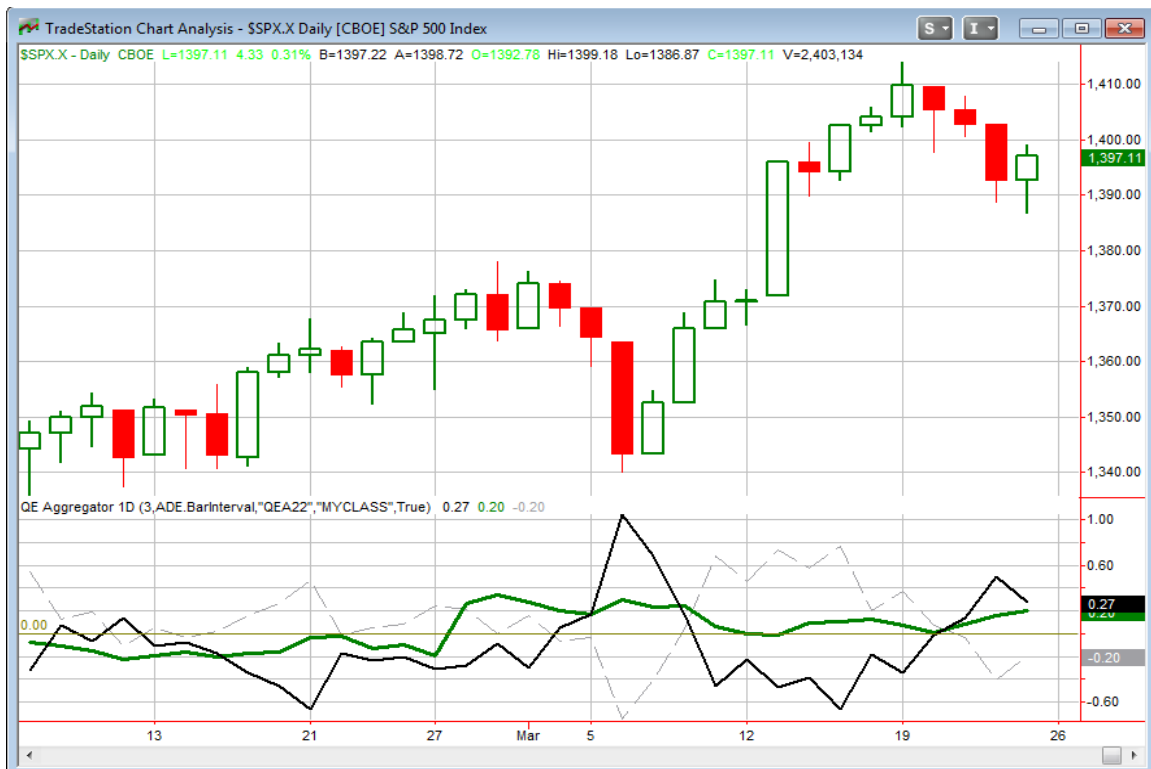
The Evidence

Intraday action was quiet all week and Friday was no exception. The indices closed mostly higher on Friday, with the Nasdaq 100 the only loser. The SPX gained 0.3%, the NASDAQ rose 0.2%, and the Russell 2000 rallied 1.1%. Breadth was squarely positive as the NYSE Up Issues % came in at 71% and the Up Volume % was 72%. Volume dipped a bit from Thursday's level.

The mild bounce on Friday failed to generate any compelling studies. This is not terribly surprising. The current market setup, where it has wiggled back and forth over the last few days and stands near the middle of its recent 2-week range, is typical of the kind of environment where edges are not as pronounced. This leaves us with just 2 short-term active studies, both of which are bullish. Just three days ago the number of active short-term studies was 6.

Of course when the number of active studies is low that means that new studies will have a greater impact on expectations and the Aggregator. So action over the next few days will be interesting and may also prove critical in formulating our bias.

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



Friday's action did not dramatically alter the Aggregator chart. The green Aggregator Line remained strongly positive. Readings above 0 mean net expectations from the Active List are for upside over the next few days. The black Differential Line also remained well above 0. A positive Differential reading means the SPX has underperformed expectations over the last few days. So net expectations are bullish and the SPX is oversold versus recent expectations. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. This meant the Aggregator System remained long at the close. This was noted on the systems page before the bell.

Based on the current studies, expectations are scheduled to remain positive on Monday. This could change if strong bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,405.29 on Friday. This is 0.6% above Friday's close. This means the SPX will need to close at least this much higher if it is going to move from oversold to overbought, and cause the Differential Line to close back below zero.

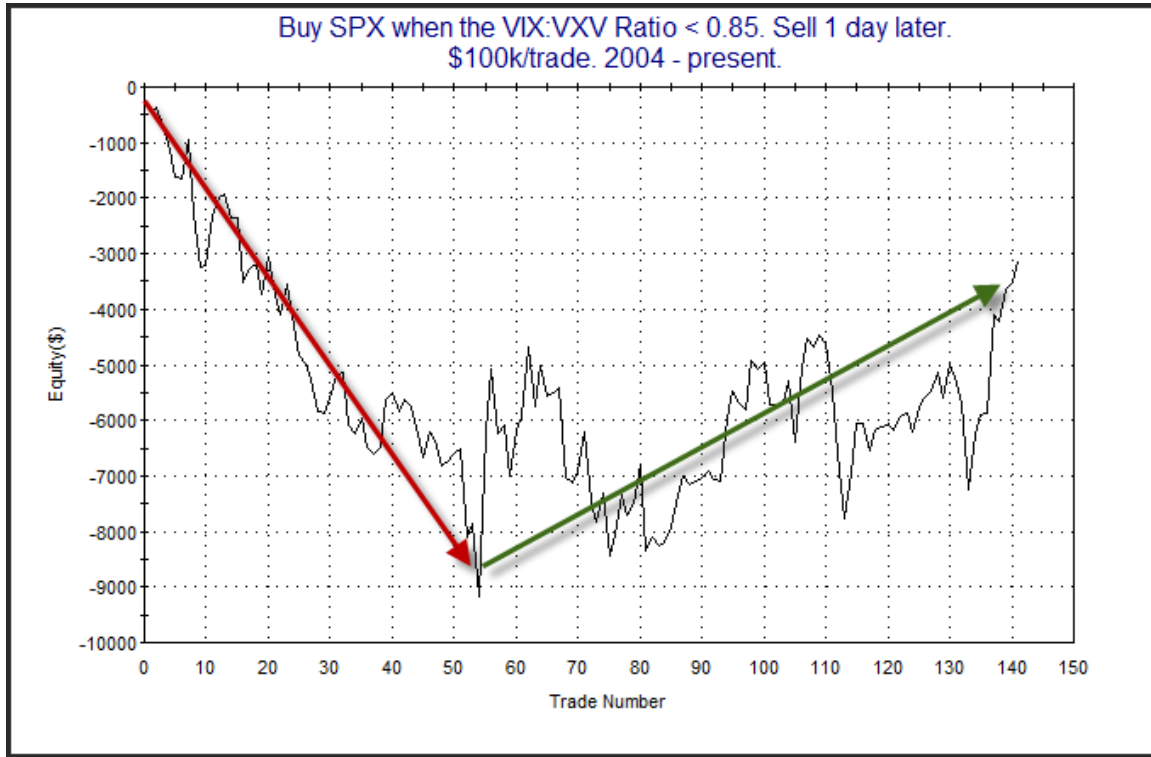
It appears the most likely scenario is a move up over the next few days. I already have some long exposure. At this point I'm not going to add to it. Should the SPX close above the 1405.29 Differential Pivot on Monday I will take profits on my index position. I won't necessarily exit all of my long positions, though.

Intermediate-term Outlook (2 weeks – 2 months)– updated 3/26 – moderately bullish
SPX hit a new high on Monday, but then pulled back for a few days after that. After 5 consecutive up weeks, this last one finished down slightly (less than 0.5%). The Nasdaq 100 finished higher, though, making it 12 up weeks in a row. This is only the second time that the NASDAQ 100 has posted such a lengthy streak. The record for the NASDAQ 100 is 14 weeks. That streak ended in January of 1999. The bottom line for the market is that the uptrend appears to be squarely intact.

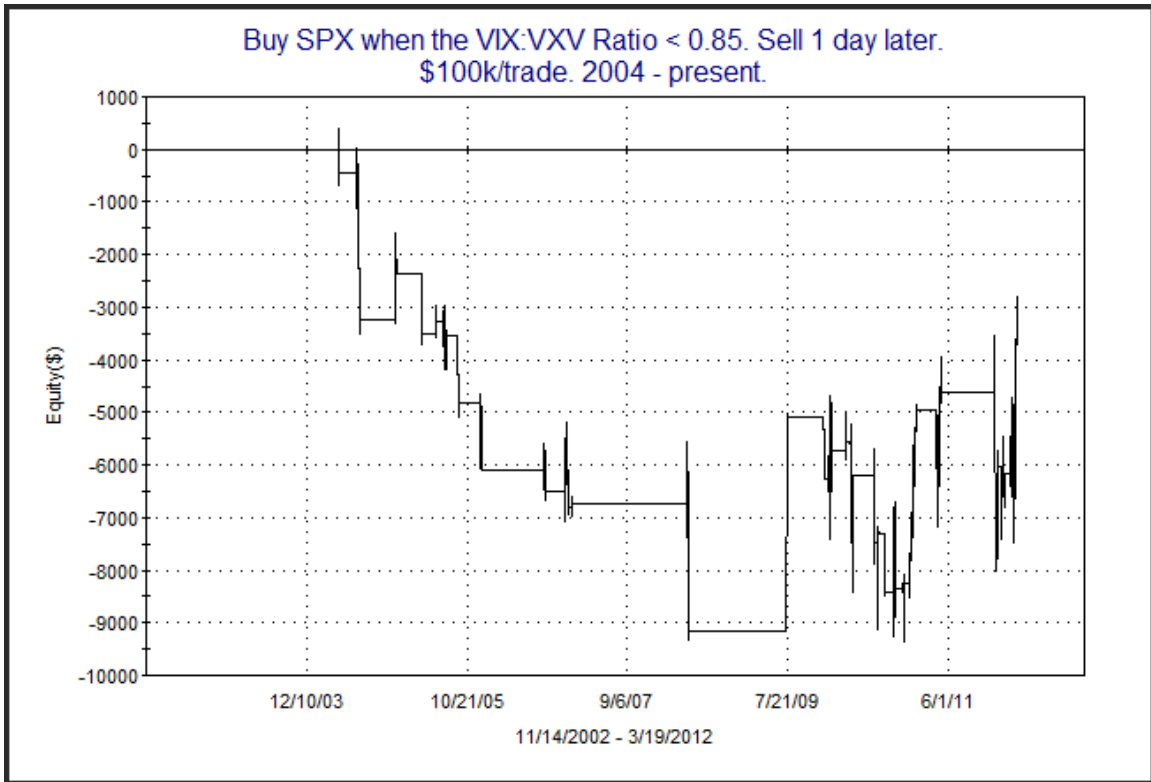
The mild pullback and choppy action this past week failed to produce any new studies with intermediate-term implications. One notable market condition that I examined in the 3/20 subscriber letter is the extremely low VIX:VXV ratio. A subscriber had asked whether the current low reading was perhaps a sign that the VIX is likely to spike. Below is an excerpt from the 3/20 subscriber letter in which I replied.

There was a time when a very low VIX:VXV ratio seemed to reliably suggest a market pullback (and volatility spike). But over the last few years this has not been the case. The graphic below demonstrates this point. It shows results of buying the SPX whenever the

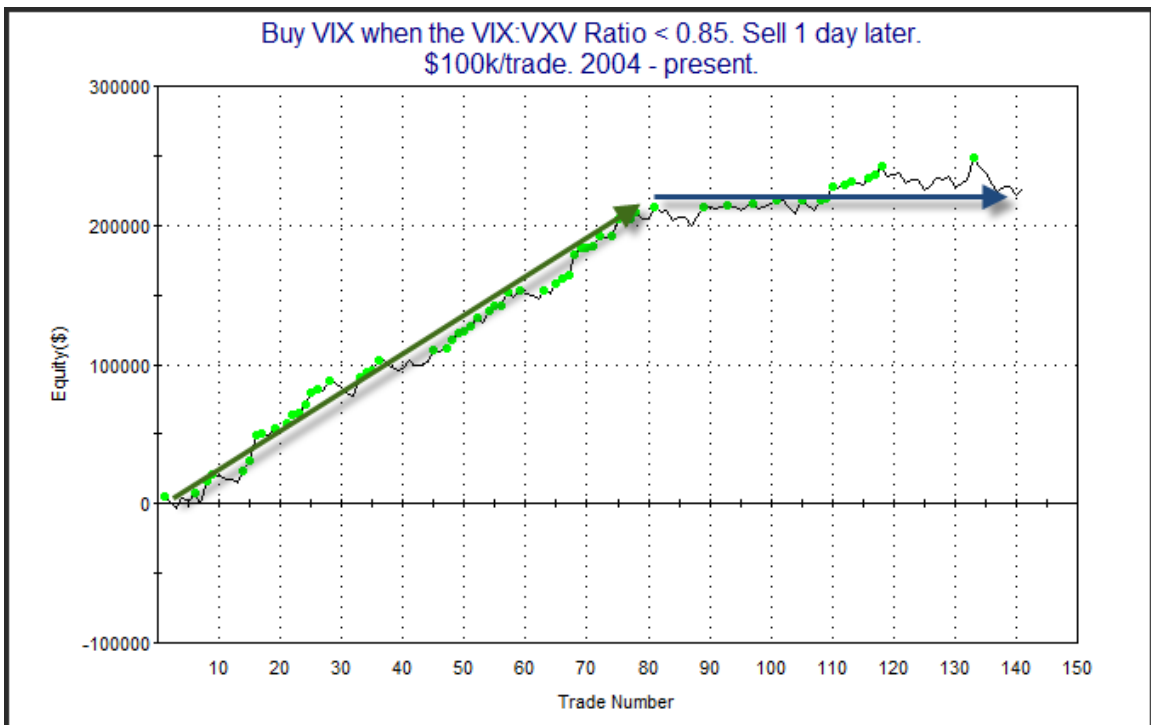
VIX:VXV ratio closes below 0.85. The trade is exited when the ratio moves back above 0.85.



As you can see the first 50+ instances of this were routinely followed by dips in the market. But since then there have been close to 90 instances, and if anything they would appear to suggest more of an upside bias. The chart below is the exact same, except I showed a timeline rather than instance based.



What we see here is that the downside edge appears to have stopped working after the market bottomed out in the spring of 2009. But we also want to see how the setup has affected the VIX, not just SPX. So below is the VIX profit curve.



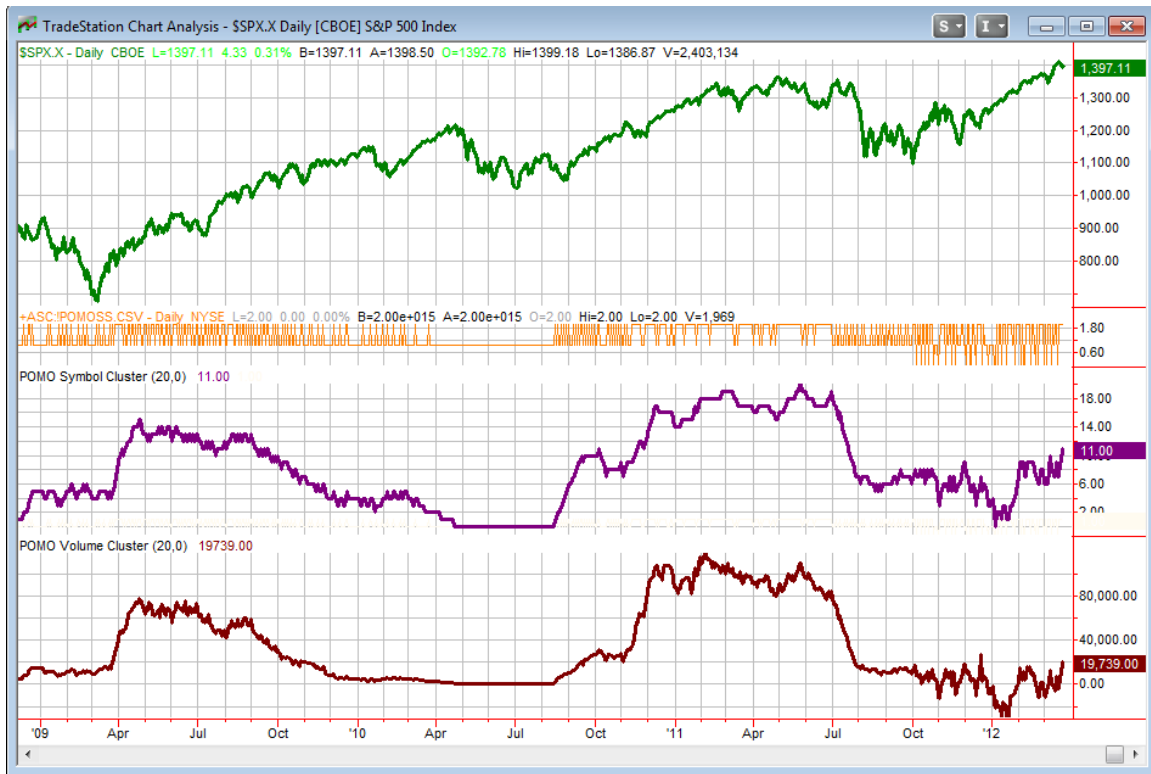
The change here is not as blatant, but clearly the upside VIX tendency under such conditions is no longer prevalent.

A very low VIX:VXV ratio means that short-term volatility expectations are significantly lower than long-term volatility expectations. It appears the habit of traders prior to the 2008 bear market may have been to underestimate short-term volatility expectations. But since that bear market ended, very low readings have more likely been due to futures traders overestimating longer-term expectations, rather than underestimating short-term expectations. They've been paying too much for long-term portfolio protection in recent times, and until that changes a low VIX:VXV ratio will continue to be a less than ominous setup.

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>



This past week we saw Fed buying every single day. This is the first time since June of 2011 when QE2 was still in force that the Fed performed POMO buying activity five days in a row. The net result was a little over \$15 billion of buying. That is a very strong liquidity inflow, and it took our intermediate-term indicators to the upper edges of their post-QE2 range.

This upcoming week we are scheduled to see some outflows. Monday and Thursday there is selling scheduled, and Tuesday, Wednesday, and Friday the Fed has scheduled buying. But with the buying days being smaller, the net result is expected to be a liquidity outflow of nearly \$8 billion.

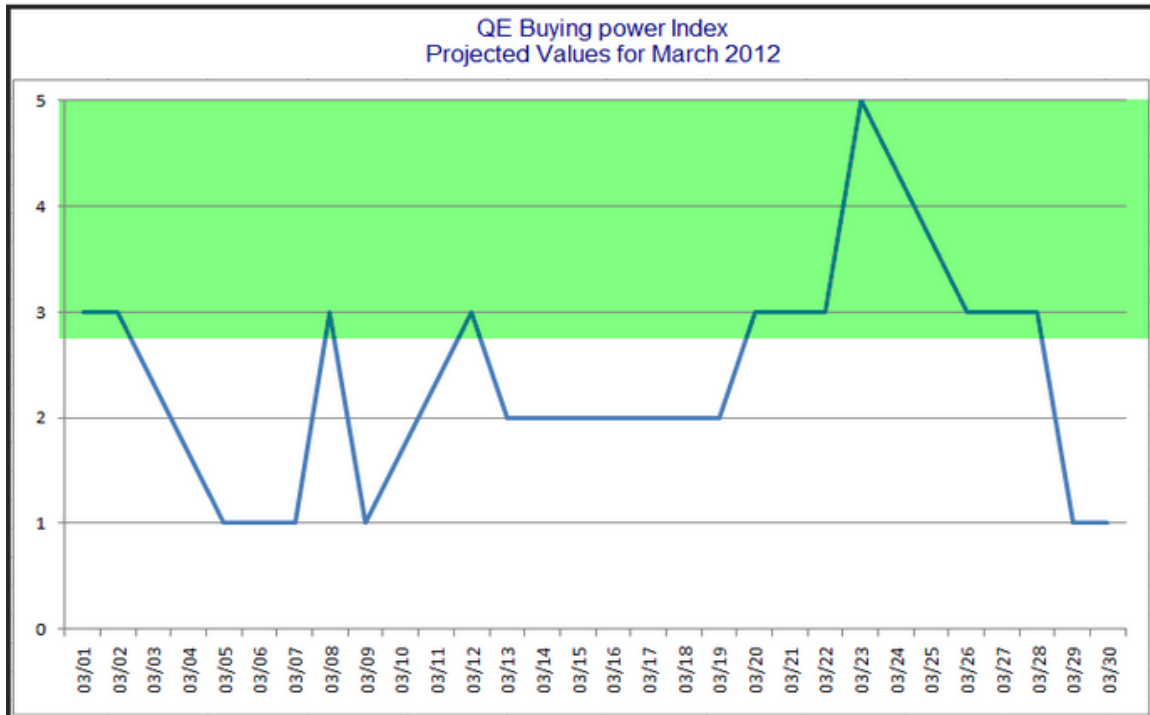
The current schedule only goes through Friday. At around 2 PM on Friday the Fed is set to release its schedule for April. Traders should be able to access that schedule by using the link below.

http://www.newyorkfed.org/markets/tot_operation_schedule.html

I also thought it might be interesting to take another look at the March QE Buying Power Index. The chart below is taken from the QE Buying Power Index information page on

the website. Link to the webinar, presentation slides, Tradestation Code, Fed links and more can be found on that page.

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



Looking back at March, the QE Buying Power Index suggested that shorting might be a difficult endeavor, because there were no periods scheduled where POMO selling dominated (readings of 0 or below). To this point that has certainly turned out to be true. There has been only one day so far this month in which the SPX has closed in the bottom 20% of its 10-day range. That was on 3/6/12 and it occurred when the QE Buying Power Index was at a neutral "1". The most significant edges over the last several years have occurred when the market has moved opposite the QE Buying Power Index for a short period of time. In such cases, the liquidity action has helped the market to revert. So the bottom line in March has basically been that the market has moved in conjunction with the QE Buying Power Index, and its failure to get off-track at any point has led to a dearth of tradable opportunities.

From an intermediate-term standpoint it is still somewhat surprising that the market has managed to rally so strongly over the last 3-4 months with just a moderate amount of

help from POMO. There is no QE3 scheduled at this point, and though Operation Twist is helping to provide some support for the market, I don't believe it is enough to prevent an intermediate-term market correction.

Without a strong quantitative easing policy liquidity shocks could hit the market at any time. Aside from POMO, we should remain mindful of breadth divergences and possible negative impacts from rising interest rates. Still, there appear to be more positives than negatives for the intermediate-term. The persistent uptrend, the leading Nasdaq, the recent breakout and positive price action are all hinting at a continuation upwards. This has me in a similar state of mind to the last couple of weeks. I am still willing to take trades in either direction. While not all-out bullish, I am more comfortable being aggressive with long trades than with shorts.

Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

Open Catapult Triggers

HPQ – bought 1/3 @ \$23.03

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 1(HPQ)

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
XIV(1/2)	3/6/2012	\$8.48	\$12.24	44.34%	\$9.49	Aggressive VIX
SPY(1/4)	3/22/2012	\$139.18	\$139.65	0.34%		Aggregator
HPQ(1/3)	3/23/2012	\$23.03	\$23.63	2.61%		Catapult

SPY – I will exit the SPY trade idea on an SPX close \geq 1,405.29.

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