

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 23, 2012

Volume 5 Issue 140

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 drops from 50-day highs have consistently been followed by bounces over the last 7 1/2 years.
- POMO flows are about to get very bullish.

Short-term Outlook

The Bottom Line

The Outlook now appears to be moderately bullish. I may start to scale into a long position if the market closes down on Monday.

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

Study Date	Description	Time span	Bias
Active			
July 23, 2012	Big drop from 50-day high	1-4 days	Bullish
July 20, 2012	3 up, 50-high, 3 up vol.	1-2 days	Bullish
July 20, 2012	High close Thurs before op-ex	1-5 days	Bearish
Active - Long Term			
July 16, 2012	POMO modestly bullish	int term	Bullish
June 13, 2012	FTD with modest breadth & vol	int term	Bearish
February 1, 2012	Golden Cross	int term	Bullish
Dropped Tonight			
July 20, 2012	SPX 50-high. VIX:VXV < 0.85	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

The market had a tough day on Friday. The SPX lost 1%, the Nasdaq fell 1.4%, and the Russell 2000 declined 1.3%. Breadth was squarely negative as the NYSE Up Issues % came in at 32% and the Up Volume % was 23%. Total NYSE volume spiked to the highest level so far in July, but that's typical on an options expiration day.

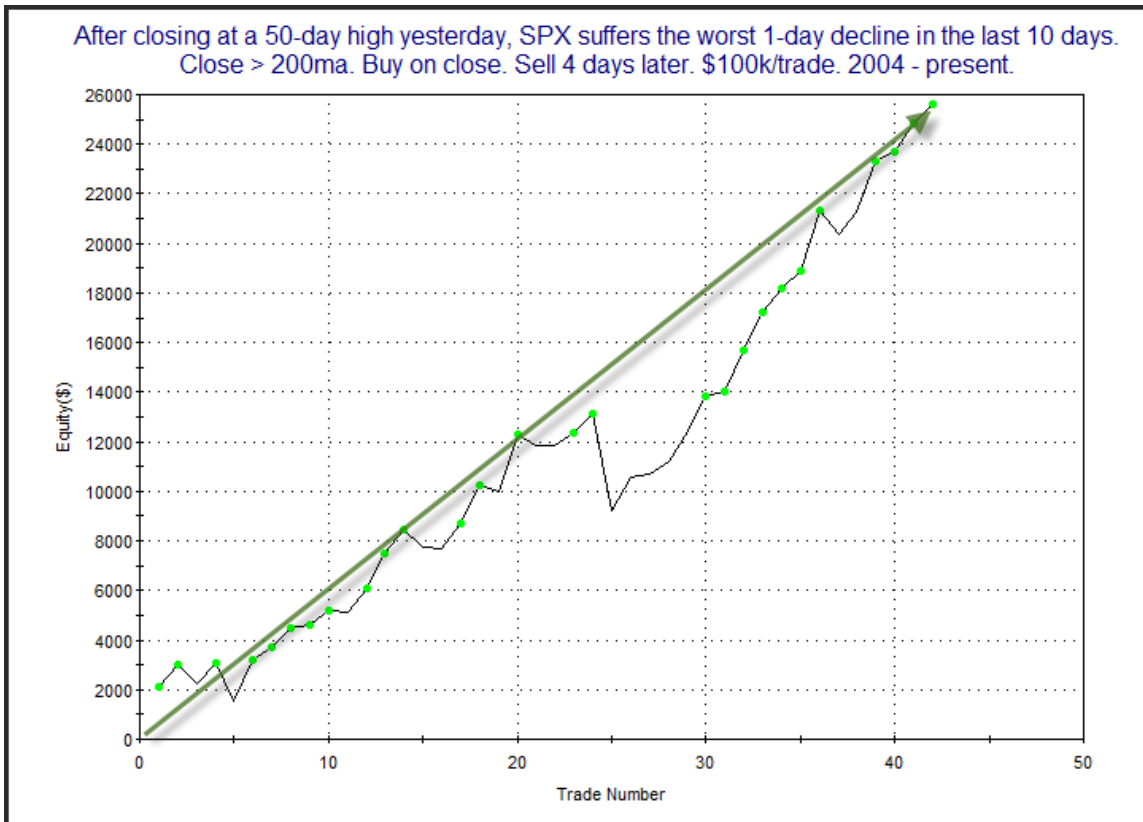
There were a few studies that triggered in the Quantifinder on Friday, and they were quite mixed. I took a look at all of them and found none of them to be terribly compelling. The bearish ones seemed to have shown some bullish signs recently, and the bullish ones seemed to look more bearish and recent results. Also, some of those with solid results used volume as a filter. I don't like utilizing studies that require high volume on options expiration, because as I mentioned above high volume is typical on options expiration. So after going through a number of studies, I re-examined the current setup in a way that seemed to collectively, and fairly, describe the current market situation. The study below considers such factors as Thursday's 50-day high, Friday's oversized drop, and the long-term trend.

After closing at a 50-day high yesterday, SPX suffers the worst 1-day decline in the last 10 days.
Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 2004 - 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	18,365.77	39	27	12	69.23	1,342.75	2,693.34	-1,490.70	-3,454.00	0.90	2.03	470.92
4	25,634.01	42	32	10	76.19	1,071.13	2,399.28	-864.21	-3,895.76	1.24	3.97	610.33
3	18,355.44	43	31	12	72.09	831.00	2,159.82	-617.14	-1,720.40	1.35	3.48	426.87
2	8,545.79	43	24	19	55.81	798.87	2,437.50	-559.32	-1,550.06	1.43	1.80	198.74
1	3,162.74	43	25	18	58.14	504.69	1,249.60	-525.24	-1,354.59	0.96	1.33	73.55

39 of 43 instances (91%) closed above the entry price at some point in the next 4 days.

This setup hasn't always shown such a strong upside tendency, but over the last 7 1/2 years it certainly has. And the 3-4 day consistency appears especially impressive. Below is a profit curve that assumes a 4-day holding period.



The strong upslope seems to confirm the bullish inclination. I've included this study on the active list.

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



With tonight's study factored in the green Aggregator Line managed to hold above zero. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the strong selloff caused the black Differential Line to spike up and close above 0. This means the SPX is oversold versus expectations. So net expectations are moderately bullish and the SPX is somewhat 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 changed from flat to long. But as you can see, it just barely qualified.

Based on the current studies, expectations are slated to remain slightly bullish on Monday. Of course that could change if bearish evidence emerges. The Differential Pivot will be 1,373.61 on Monday. This is 0.8% above Friday's close. So it would take a rally of his least this much to work off the oversold condition.

So there appears to be a mild bullish edge at the moment. I am mostly flat, but have some bullish exposure via a long XIV position. With the upside edge apparently so moderate, I'll take a conservative approach to possibly scaling in to a long index position on Monday, and only enter if the SPX closes lower.

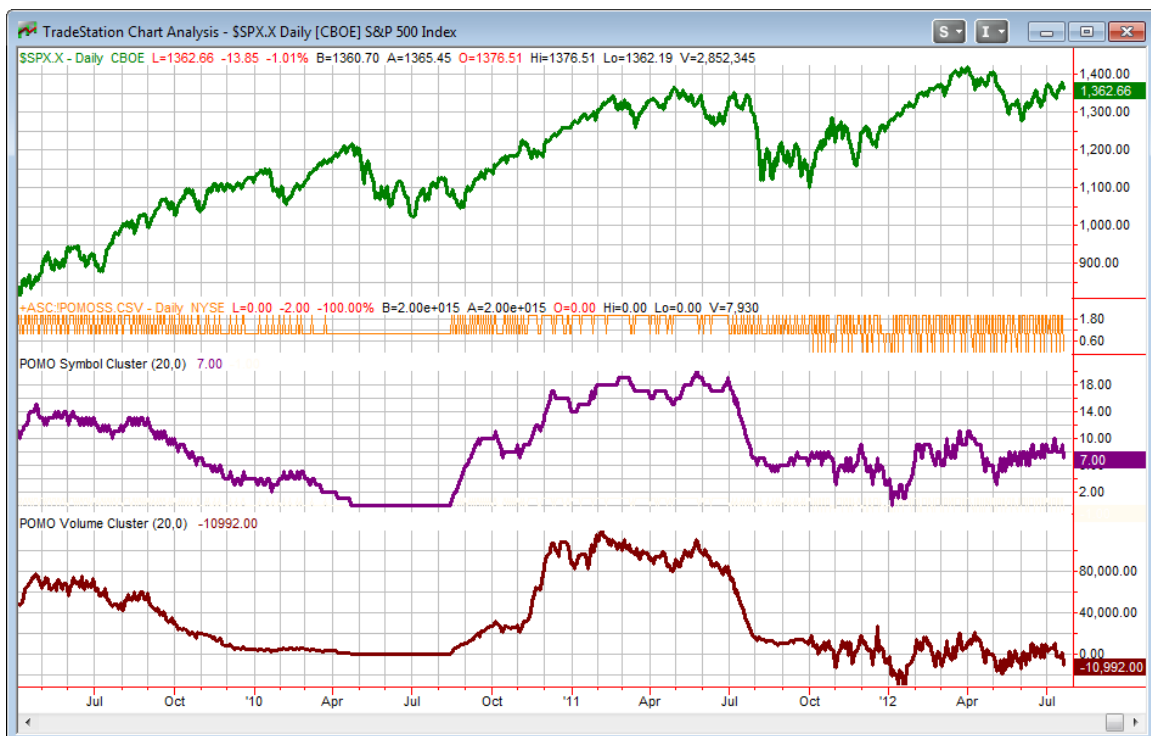
Intermediate-term Outlook (2 weeks – 2 months)– updated 7/16 – slightly bullish

Back and forth trading this week left the market up a mild 0.4%. Making a new 50 day high was somewhat encouraging, but strong upside evidence and momentum are still lacking.

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>



As expected there were three days of POMO buying and two days of selling this past week. But the net outflows were larger than expected and amounted to \$7.5 billion. This left the intermediate-term indicators at their lowest points in quite a while, so it's not surprising to see that the market has made little progress over the last four weeks.

But from here through the end of the month POMO flows are expected to improve dramatically. There is only one selling day scheduled during the next seven trading days, with the rest all scheduled to see liquidity inflows. The net result of this buying is estimated to be about a \$12 billion inflow. The impact of this inflow is anticipated to be felt near the end of the month and the beginning of August.

Intermediate-term evidence remains mixed. I am feeling just slightly more bullish this week since we are now beyond last week's bout of POMO selling. Of course liquidity flows don't typically have an immediate impact and selling we saw this past week could continue to exert itself for several more days before the positive influence of the upcoming inflows takes over. While choppy, the trend also appears to favor the bullish case. So as has been the case recently, I am still more willing to buy oversold than I am to short overbought.

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 @ \$136.46 LIMIT ON CLOSE. This is based on the short-term outlook above.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
XIV(1/2)	7/11/2012	\$11.64	\$13.39	15.03%	\$11.70	Aggressive VIX

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