

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 24, 2012

Volume 5 Issue 141

Market Overview



Signals Overview

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

Tonight's Research Points

- 2 unfilled down gaps under similar circumstances has commonly been followed by a bounce over the next few days.

Short-term Outlook

The Bottom Line

The outlook is getting more bullish. I may continue to scale in if the market keeps selling off.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
July 24, 2012	2 unfilled down gaps >200ma. 5 low	1-5 days	Bullish	1.80%
July 23, 2012	Big drop from 50-day high	1-4 days	Bullish	1.20%
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	High close Thurs before op-ex	1-5 days	Bearish	-1.80%
July 20, 2012	3 up, 50-high, 3 up vol.	1-2 days	Bullish	

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

The Evidence

Monday was another tough day for the market. The SPX lost 0.9%, the Nasdaq fell 1.2%, and the Russell 2000 declined 1.6%. Breadth was squarely negative as the NYSE Up Issues % came in at 24% and the Up Volume % was 18%. Total NYSE volume fell below the level of the last 3 days

One notable aspect of the price action over the last 2 days is that both Friday and Monday posted unfilled gaps down – never reaching breakeven at any point during the day. This triggered a number of related studies in the Quantifinder on Monday. I'll cover a couple of the more compelling ones here.

This first study looked at other instances where SPY left 2 unfilled down gaps while trading above the 200ma. It was last seen in the 11/24/10 letter and has been updated below.

SPY leaves an unfilled gap down for the 2nd day in a row. It closes > 200ma. Buy on close. Sell X days later. \$100k/trade. 1998 - 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	17,920.19	20	16	4	80.00	1,630.00	3,940.02	-2,039.94	-3,627.12	0.80	3.20	896.01
4	12,629.98	20	14	6	70.00	1,379.44	4,388.28	-1,113.69	-3,342.64	1.24	2.89	631.50
3	8,572.65	20	13	7	65.00	1,180.79	3,325.14	-968.23	-2,747.01	1.22	2.26	428.63
2	4,254.58	20	10	10	50.00	1,170.57	2,948.14	-745.12	-2,436.12	1.57	1.57	212.73
1	2,258.52	20	11	9	55.00	838.74	1,974.15	-774.18	-1,849.26	1.08	1.32	112.93

18 of 20 instances (90%) closed above the entry price at some point in the next week.

As you can see there has been a strong upside tendency to bounce over the next week. That tendency was not nearly as prominent prior to 1998, which is why the study does not look back further than that.

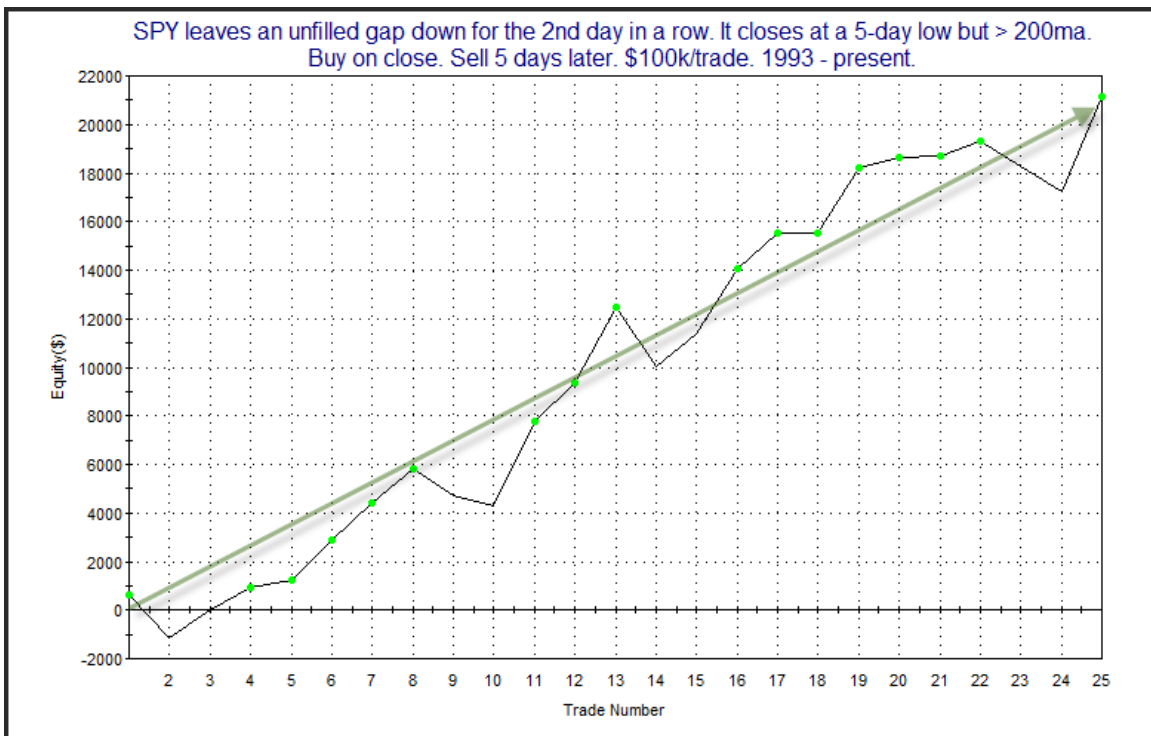
But if we also require a 5-day low close then we are talking about a setup that has suggested an upside edge since the inception of the SPY in 1993. I last showed this in the 7/12/11 letter and have updated the results below.

SPY leaves an unfilled gap down for the 2nd day in a row. It closes at a 5-day low but > 200ma.
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	21,172.65	25	19	6	76.00	1,527.55	3,940.02	-1,308.48	-2,465.95	1.17	3.70	846.91
4	17,339.86	25	18	7	72.00	1,350.81	4,388.28	-996.38	-1,920.60	1.36	3.49	693.59
3	13,979.34	25	17	8	68.00	1,165.51	3,325.14	-729.29	-1,645.38	1.60	3.40	559.17
2	7,383.24	25	16	9	64.00	998.29	2,948.14	-954.38	-2,436.12	1.05	1.86	295.33
1	1,484.85	26	15	11	57.69	692.47	1,974.15	-809.29	-1,849.26	0.86	1.17	57.11

Only 1 instance failed to close above the entry price at some point in the next 6 days. That instance took place on 9/14/99.

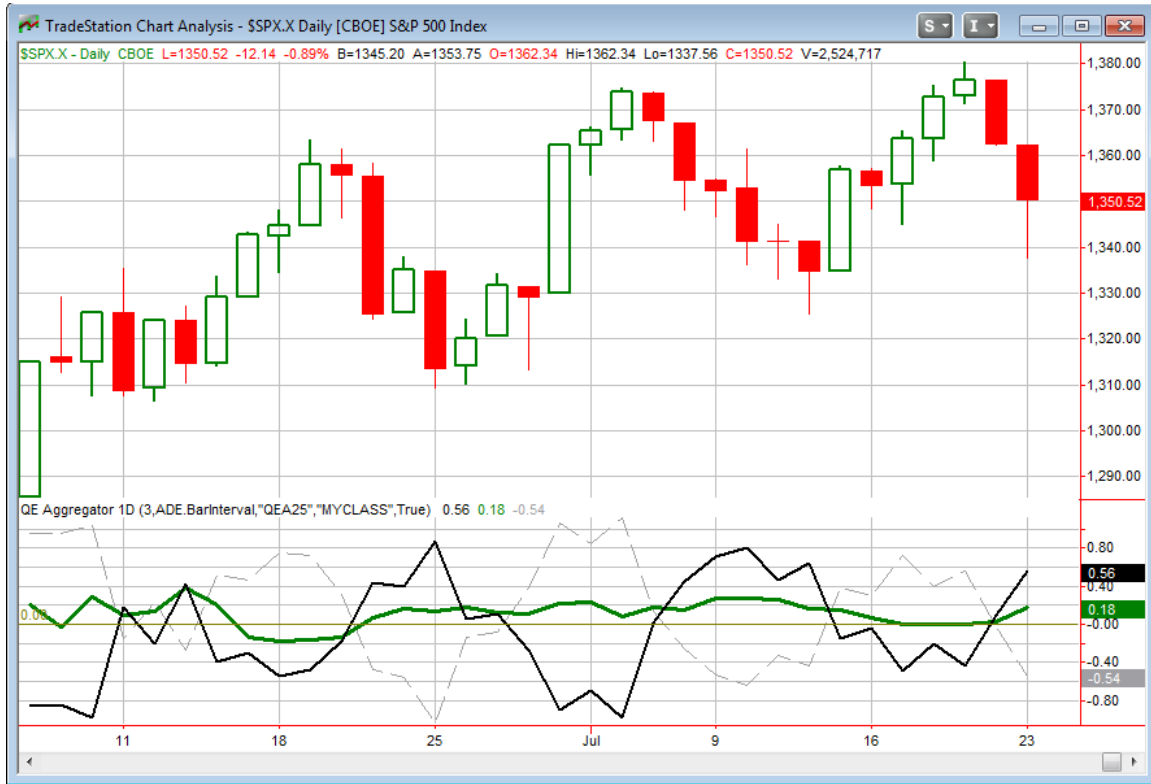
Here again the numbers appear to suggest a strong tendency for a bounce in the next few days. This study also had the most impressive profit curves of the 2-gap studies I looked at tonight. Below is the profit curve assuming a 5-day holding period.



The steady upward slope acts as confirmation of the bullish edge.

It appears the double-unfilled down gaps suggest a decent upside edge over the next few days. I'll also briefly remind everyone that **Tuesday is the most likely day of the week to experience an oversold bounce.**

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



With tonight's study factored in the green Aggregator Line headed further 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 settle strongly above 0. This means the SPX is oversold versus expectations. So net expectations are bullish and the SPX is strongly 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, but now appears to have more conviction than the meek signal we saw in last night's letter.

Based on the current studies, expectations are slated to remain bullish on Tuesday. Of course that could change if bearish evidence emerges. The Differential Pivot will be 1,376.19 on Tuesday. This is 1.9% above Monday's close. It pretty unlikely we'll see the SPX make up that much ground in 1 day. A more likely scenario would be a multi-day rally or consolidation to work off the oversold condition.

This pullback appears to be playing out in a way that would typically generate a fairly quick bounce. I should also remind readers that the QE Buying Power Index is slated to reach 3 on Tuesday and stay at that bullish level through the end of the month. The strong liquidity inflow we are in now in the midst of should help to dampen declines and aide bounces. For the QE Buying Power Swing System to trigger long tomorrow would take an SPX close of 1,336.40 or lower. And as I show in the Trade Ideas section lower down, that is where I intend to place my “limit on close” order.

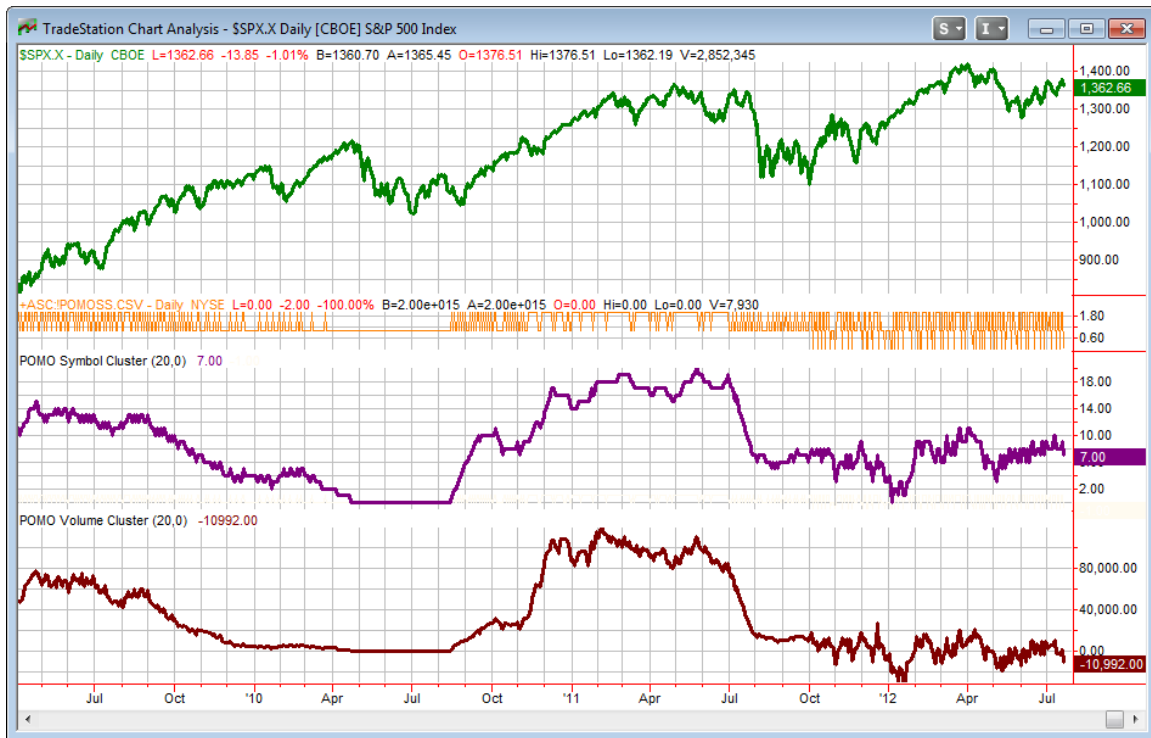
Intermediate-term Outlook (2 weeks – 2 months)– updated 7/16 – slightly bullish

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 ON CLOSE if SPX closes \leq 1,336.40. This is based on the short-term outlook above. A close in this area would likely trigger a long signal for the QE Buying Power Swing System.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
XIV(1/2)	7/11/2012	\$11.64	\$11.62	-0.17%		stopped on open
SPY(1/4)	7/23/2012	\$135.09	\$135.09	0.00%		bought on close

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