

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 4, 2012

Volume 5 Issue 170

Market Overview



Signals Overview

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

Tonight's Research Points

- The turn of the month is seasonally strong.
- Post Labor-Day after a move higher in the previous 20 days has been weak.
- POMO flows are expected to be strong for the next 3 days, before seeing a liquidity contraction from the 7th – 20th.

Short-term Outlook

The Bottom Line

The bounce arrived as expected on Friday, but it still appears we should see a bit more upside in the next few days. I'm partially long.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
September 4, 2012	Post Labor-Day negative seasonality	1-4 days	Bearish	-1.30%
September 4, 2012	Early-month oversold in uptrend	1-5 days	Bullish	2.20%
August 31, 2012	QE Buying Power Swing System	1-3 days	Bullish	1.80%
Active - Long Term				
August 22, 2012	Key Dowside Reversal from High	1-12 days	Bullish	
August 10, 2012	SPX & TNX 50-day highs.	1-20 days	Bearish	
July 30, 2012	SPX 50-day high on 90% up vol	1-50 days	Bullish	
July 16, 2012	POMO modestly bullish	int term	Bullish	
February 1, 2012	Golden Cross	int term	Bullish	
Dropped Tonight				
August 16, 2012	SPY 50-high on 20-low vol	1-10 days	Bearish	
August 15, 2012	SPY 50-high then 5-day inside range	1-10 days	Bullish	
August 31, 2012	Friday before Labor Day bullish	1 day	Bullish	

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

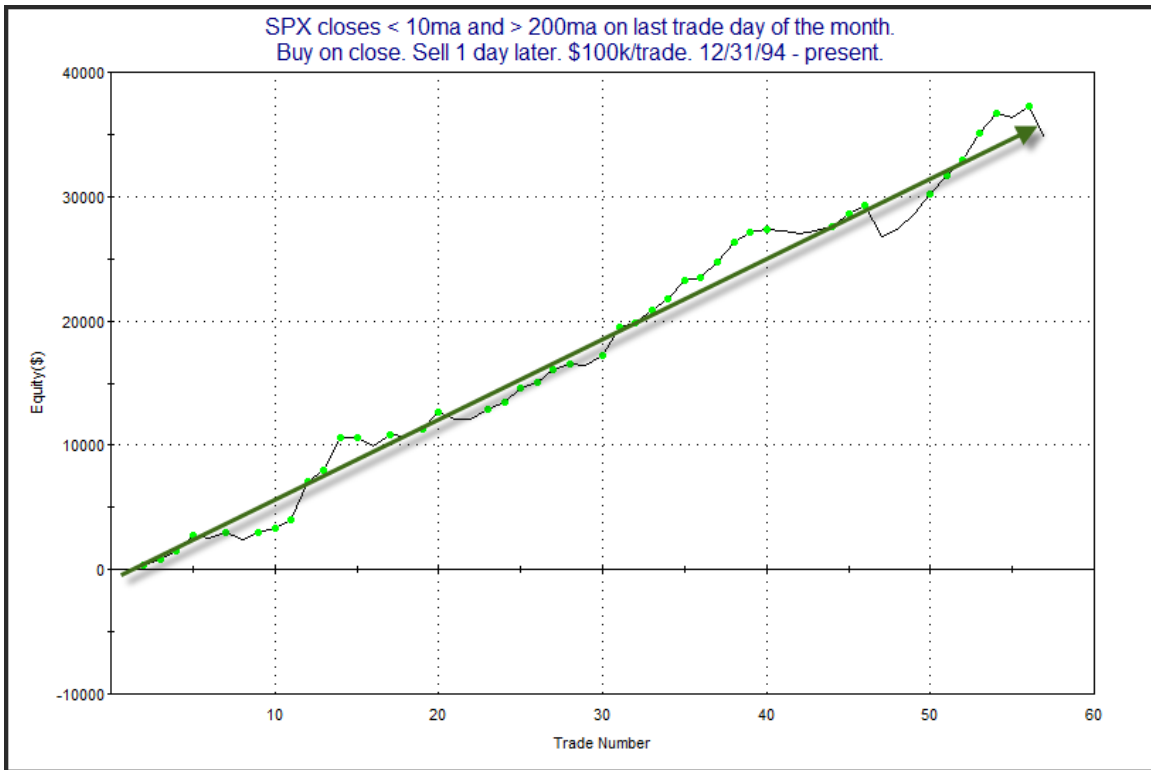
The Evidence

Some big round-trip action on Friday saw prices jump all around. In the end the indices finished with fairly solid gains. The SPX gained 0.5%, the Nasdaq rose 0.6% and the Russell 2000 closed up 0.4%. Breadth was strongly positive as the NYSE Up Issues % was 70% and Up Volume % came in at 74%. Despite the upcoming long weekend, total NYSE volume rose with all the excitement.

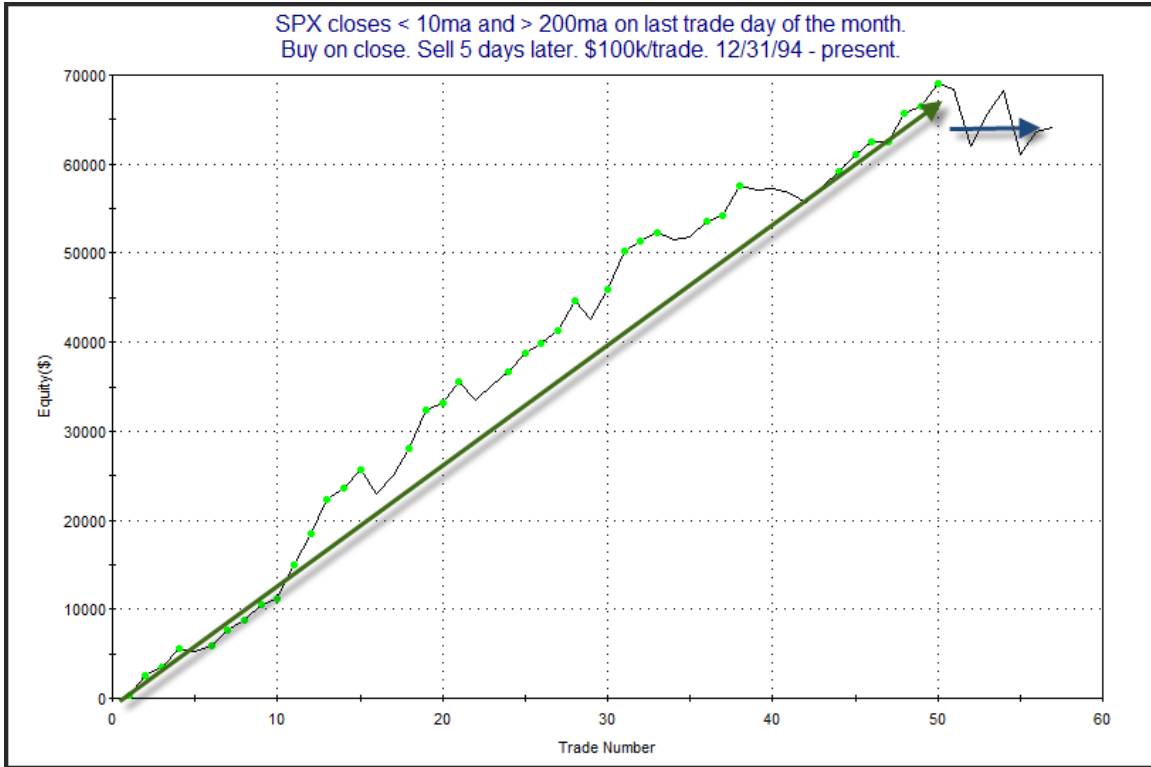
The Quantifinder noted some interesting but conflicting seasonal tendencies that may be in force over the next few days. Beginnings of new months often arrive with seasonal strength. This has especially been true 1) during long-term uptrends, and 2) when the market is not already short-term overbought. The study below was last seen in the 2/1/11 subscriber letter. It takes these concepts into account. All stats are updated.

SPX closes < 10ma and > 200ma on last trade day of the month. Buy on close. Sell X days later. \$100k/trade. 12/31/94 - 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	64,021.90	57	46	11	80.70	1,916.04	4,435.97	-2,192.35	-7,153.30	0.87	3.65	1,123.19
4	55,562.27	57	45	12	78.95	1,696.76	3,838.00	-1,732.64	-7,100.17	0.98	3.67	974.78
3	40,917.26	57	39	18	68.42	1,691.72	3,709.44	-1,392.21	-3,492.36	1.22	2.63	717.85
2	33,948.18	57	42	15	73.68	1,291.52	3,442.32	-1,353.04	-4,320.06	0.95	2.67	595.58
1	34,759.40	57	44	13	77.19	975.56	3,119.10	-628.11	-2,559.62	1.55	5.26	609.81
52 of 57 instances (91%) closed above the entry price at some point in the next week.												

Day 1 has obviously provided strong numbers, but even beyond that there appears to be some follow through over the next few days. Below are profit curves for both 1-day and 5-day holding periods. First let's look at the 1-day holding period.



This is a very impressive and steady upslope. It certainly seems to confirm the upside edge. Now for the 5-day holding period.



Three of the last six instances here have struggled. That's not enough to abandon the study, especially after the edge was so steady for so long. Still, it bears watching and considering whether we should just view this as a 1-day edge in the future.

One concern I had about this study when looking at it was that although SPX closed below its 10ma, it did close positive on the day. I wondered if this had a material impact on the results. So I reran the test and added the extra filter.

SPX closes < 10ma and > 200ma on last trade day of the month. Today it closed positive.
Buy on close. Sell X days later. \$100k/trade. 12/31/94 - present.

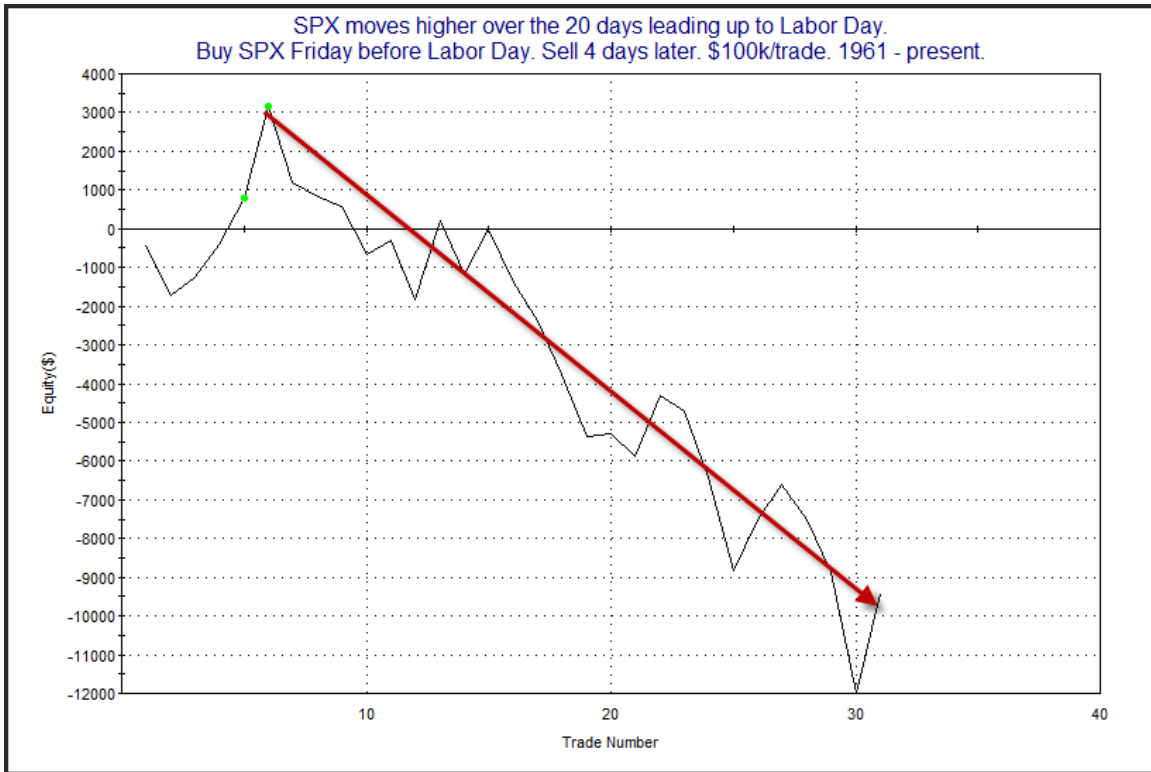
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	15,210.07	12	10	2	83.33	1,840.98	3,345.12	-1,599.89	-2,145.42	1.15	5.75	1,267.51
4	13,889.28	12	10	2	83.33	1,653.07	2,551.69	-1,320.73	-1,831.35	1.25	6.26	1,157.44
3	7,019.26	12	9	3	75.00	1,269.29	3,067.26	-1,468.10	-2,321.70	0.86	2.59	584.94
2	4,153.17	12	7	5	58.33	1,124.47	2,849.26	-743.62	-1,395.15	1.51	2.12	346.10
1	9,034.79	12	9	3	75.00	1,104.72	2,656.33	-302.55	-574.56	3.65	10.95	752.90

Results have actually been slightly stronger under these circumstances. Not so much that I would view it as a useful filter, but it certainly alleviates any concern about Friday's up close being a problem.

The other seasonal studies shown in the Quantifinder had to do with the historically weak performance during the week of Labor Day. This has been especially true when the previous 20 trading days (four weeks) have shown a net positive return. The study below was last seen in the 9/8/09 blog. I have updated the results.

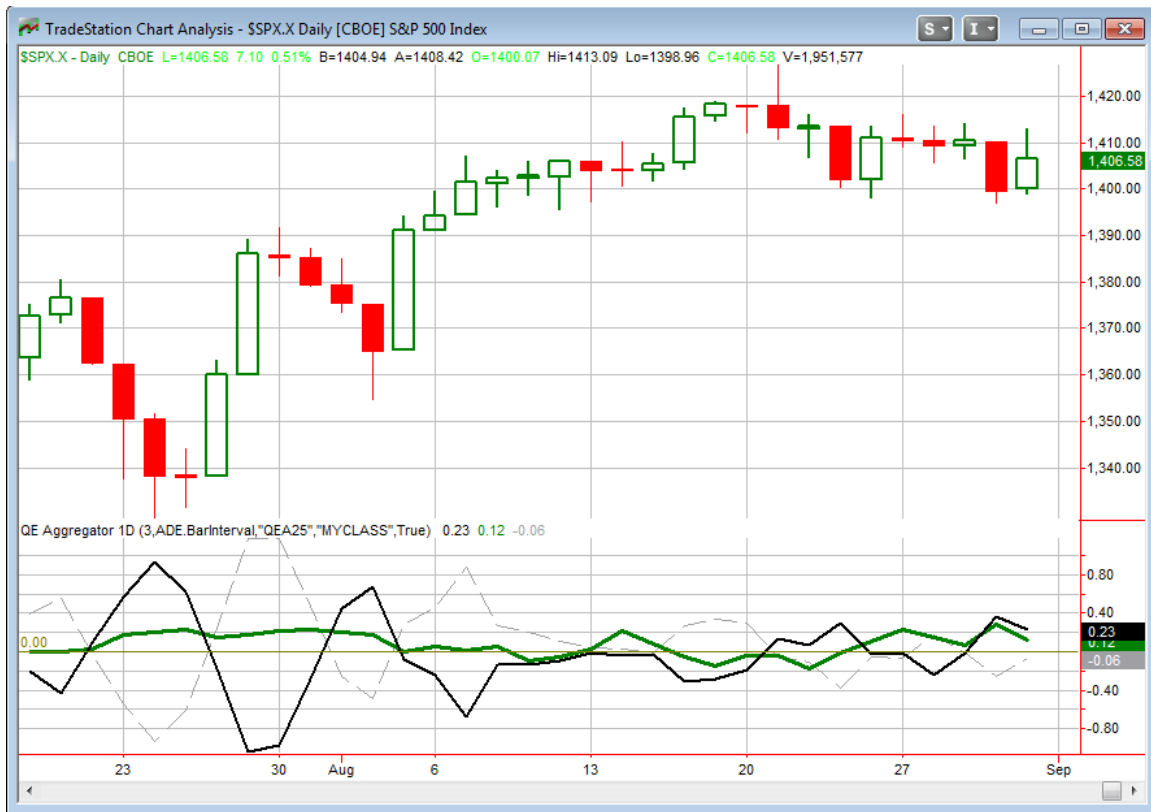
SPX moves higher over the 20 days leading up to Labor Day. Buy SPX Friday before Labor Day. Sell X days later. \$100k/trade. 1961 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-11,710.83	31	11	20	35.48	1,289.65	3,228.12	-1,294.85	-2,942.07	1.00	0.55	-377.77
4	-9,413.35	31	12	19	38.71	1,239.50	2,580.34	-1,278.28	-3,113.11	0.97	0.61	-303.66
3	-6,590.40	31	16	15	51.61	994.77	2,718.52	-1,500.45	-4,024.28	0.66	0.71	-212.59
2	-5,520.65	31	13	17	41.94	1,055.30	3,047.41	-1,131.74	-2,678.02	0.93	0.71	-178.09
1	-4,090.67	31	17	14	54.84	631.48	1,745.28	-1,058.99	-4,147.45	0.60	0.72	-131.96

The edge here isn't overwhelming, but it does seem to be worth taking into consideration. Below is an equity curve using a 4-day holding period.



Certainly choppy but it does appear to serve as some confirmation of a downside edge.

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



With tonight's studies factored in the green Aggregator Line remained well above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line is also still squarely positive. This means the SPX is oversold versus recent expectations. So net expectations are bullish and the SPX is currently oversold. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. This lead the Aggregator to remain long at the close. This was indicated as likely on the systems page shortly before the bell.

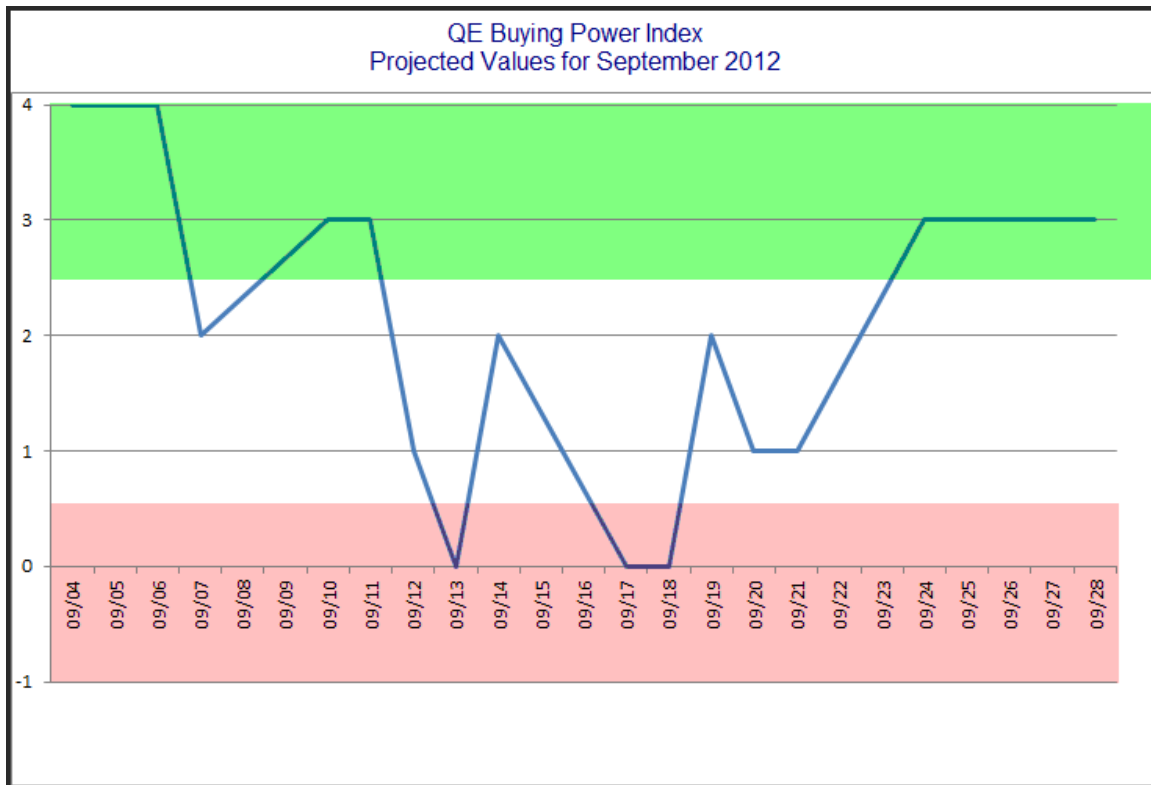
Based on the current open studies, expectations are scheduled to remain positive on Monday. Of course this could change if more bearish evidence emerges. The Differential Pivot will be 1,416.72 on Friday. This is 0.7% above Friday's close. So it would take a fairly strong close higher on Monday to move the SPX back into overbought territory.

Friday's bounce was a good start, but between turn of the month seasonality and strong POMO flows we should get some more out of it. I'm partially long, but if SPX closes above the Differential Pivot and moves into overbought territory, I'll take my profits.

Intermediate-term Outlook (2 weeks – 2 months)– updated 9/4– bullish

For the 2nd week in a row the SPX underwent a mild pullback. Action for most of the week was very mild and it failed to generate any studies of intermediate-term significance. But the September POMO schedule was announced and that made for some interesting liquidity flow data.

Based on the POMO schedule I have generated the QE Buying Power Index chart for September. It can be found on the QE Buying Power Index page at any time. I've also copied the chart below.



There appear to be 3 distinct periods to keep an eye on in September. The early part of the month is showing strongly positive flows. We could see the market rally during this time. During the middle of the month POMO flows will be negative. If we are going to see a selloff during September, this would seem to be the most opportune time for the bears to push the market lower. Once the last week of the month arrives flows will turn positive once again and act as a wind to the market's back.

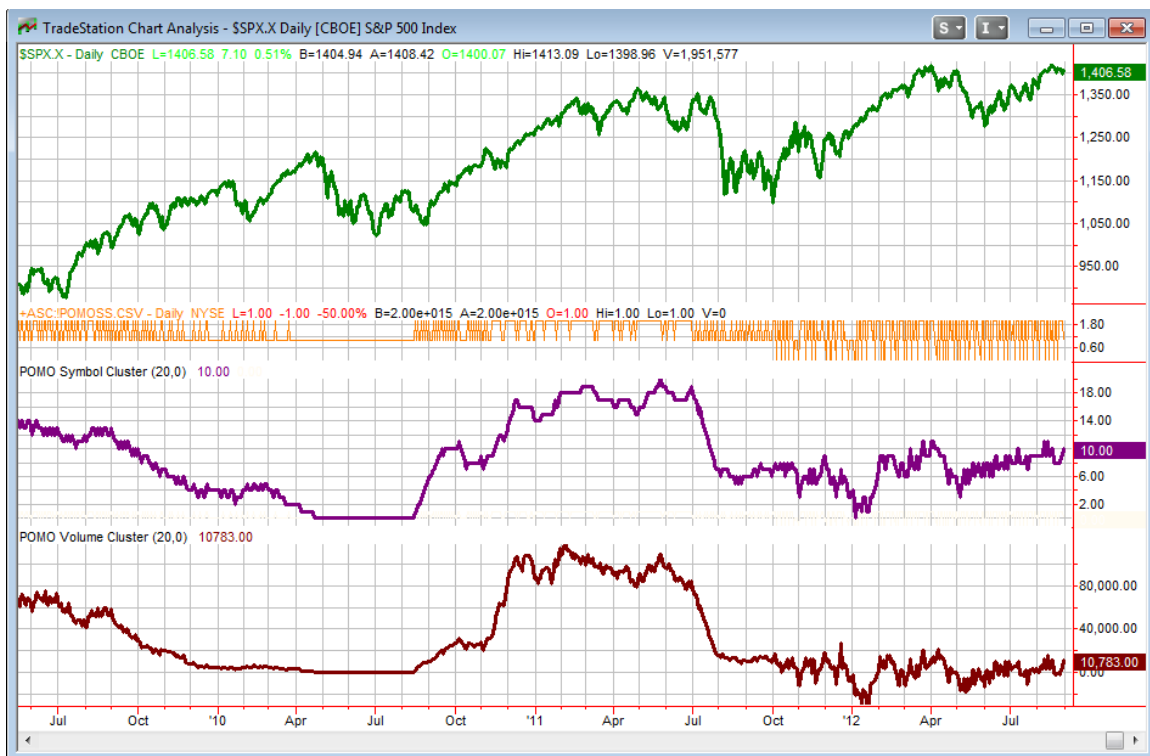
On a net basis September is expected to see \$45 billion in buying and \$38 billion in selling. The \$7 billion difference would mean the largest monthly liquidity infusion since Operation Twist began last October, topping the \$6 billion of July and August. As I mentioned above it is front and back loaded though. The first 3 days of September are

scheduled for \$13 billion in buying. Then from the 7th – 20th there will be net selling of over \$13 billion. Finally, between the 21st – 30th we'll see \$7 billion in buying.

I've updated the intermediate-term POMO chart each weekend in the letter. For those who may not recall below is a brief refresher on it. Beneath that is the 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 saw 4 days of POMO buying and 0 days of selling. The net result was a \$13.1 billion liquidity infusion. The intermediate-term indicators are both now near their highs for the last few months.

This upcoming week is scheduled to see strong buying Tuesday-Thursday. Friday will mark the beginning of the mid-month selling period. The net for this week is expected to be about a \$5.6 billion inflow, which could help the market into the following week. For anyone that would like to review the current schedule, below is a link to the fed's website.

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

We had 2 intermediate-term studies expire this week, leaving the bond-rate study as the only bearish one on the board. The bulls can look to a few positives. The uptrend is firmly intact. Momentum is positive, the Nasdaq is in a leading position, and we have existing breadth and price-related studies pointing higher. Lastly, POMO flows are positive and will continue to be so for the next few days. I remain bullish for the next few days, but will likely move toward neutral next week as POMO flows turn south.

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

ETR – 1/3 @ \$69.04

ETR – 1/3 @ \$68.65 (both remain “active” though I was stopped out)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 2/1(ETR-2)

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
<i>ETR(1/3)</i>	<i>8/22/2012</i>	<i>\$69.04</i>	<i>\$67.84</i>	<i>-1.74%</i>		<i>stopped out</i>
<i>ETR(1/3)</i>	<i>8/23/2012</i>	<i>\$68.65</i>	<i>\$67.84</i>	<i>-1.18%</i>		<i>stopped out</i>
<i>MRK(1/3)</i>	<i>8/23/2012</i>	<i>\$42.90</i>	<i>\$43.33</i>	<i>1.00%</i>		<i>sold on open</i>
XIV(1/2)	8/28/2012	\$13.88	\$13.89	0.07%		Aggressive VIX
SPY(1/4)	8/31/2012	\$140.49	\$141.16	0.48%		sell on SPX close>1,416.71

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