

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 6, 2012

Volume 5 Issue 172

## Market Overview



## Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Flat	50% Long XIV	Long	Long

## Tonight's Research Points

- Upon further review the Russell 2000 rising > 1% while SPX closes lower study from last night appears to have intermediate-term bearish implications.
- Intermediate-term lows in HV without highs in price are often followed by a price decline.

## *Short-term Outlook*

### *The Bottom Line*

Evidence is turning more bearish. I'm currently long, but hoping to take profits on Thursday.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
September 6, 2012	20-day HV 20-day lows. No 20-hi SPX	1-5 days	Bearish	-2.60%
September 5, 2012	SPX down. NYSE Up Issues % > 55%	1-2 days	Bullish	
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%
<b>Active - Long Term</b>				
September 5, 2012	Russell up 1%. SPX down	1-10 days	Bearish	
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	
<b>Dropped Tonight</b>				
August 31, 2012	QE Buying Power Swing System	1-3 days	Bullish	1.80%

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

**The Evidence**

Summer's over, but someone forgot to wake up Mr. Volatility. A tight range on Wednesday resulted in a little-changed market. The SPX lost 0.1%, the Nasdaq fell 0.2% and the Russell 2000 declined 0.1%. Breadth was mixed as the NYSE Up Issues % was 51% and Up Volume % came in at 47%. Total NYSE volume rose a bit despite the tight range.

This morning I decided to take another look at the Russell up / SPX down study from last night. I added a filter that eliminated instances that occurred in conjunction with intermediate-term lows, and ran the test out longer. What I found was quite interesting and can be seen in the stats table below.

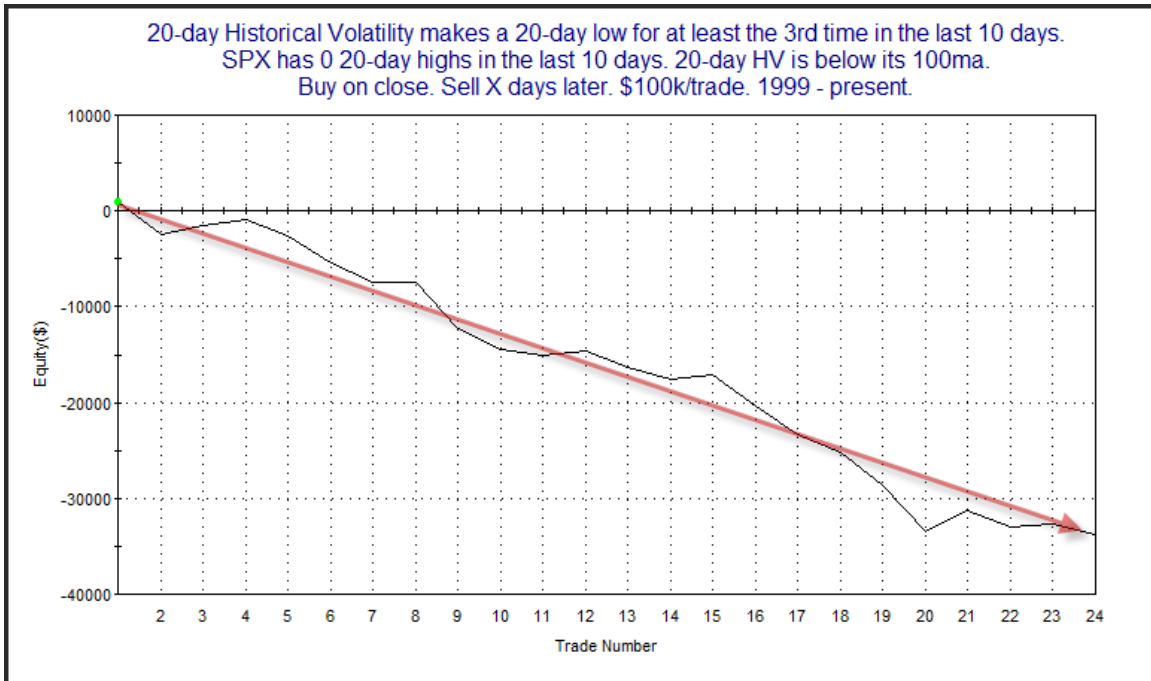
SPX closes down but <b>not</b> at a 20-day low. RUT closes up over 1%. Buy SPX on close. Sell X days later. \$100k/trade. 2000 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	-28,461.52	15	1	14	6.67	7,654.42	7,654.42	-2,579.71	-8,323.53	2.97	0.21	-1,897.43
9	-23,344.94	16	2	14	12.50	3,812.88	7,455.14	-2,212.19	-4,873.44	1.72	0.25	-1,459.06
8	-21,838.48	16	3	13	18.75	2,730.97	5,503.70	-2,310.11	-6,458.64	1.18	0.27	-1,364.91
7	-17,539.79	16	5	11	31.25	1,750.68	5,689.82	-2,390.29	-6,585.48	0.73	0.33	-1,096.24
6	-18,137.16	16	7	9	43.75	1,523.01	5,523.44	-3,199.80	-9,589.14	0.48	0.37	-1,133.57
5	1,086.20	16	8	8	50.00	2,121.26	5,379.66	-1,985.49	-4,012.80	1.07	1.07	67.89
4	10,076.25	17	8	9	47.06	3,667.66	8,095.62	-2,140.56	-4,174.20	1.71	1.52	592.72
3	3,626.10	20	11	9	55.00	1,489.26	4,047.64	-1,417.30	-2,635.20	1.05	1.28	181.31
2	782.45	20	13	7	65.00	1,065.17	4,136.62	-1,866.40	-4,296.24	0.57	1.06	39.12
1	12,299.85	21	14	7	66.67	1,251.04	2,568.00	-744.95	-2,722.05	1.68	3.36	585.71

Looking out over the next couple of weeks there has been a strong downward tendency. This may be worth keeping in mind over the next 9 days or so. I have therefore added this to the intermediate-term active list.

On Wednesday the 20-day HV hit a new 20-day low for the 3<sup>rd</sup> day in a row. It is unusual to have historical volatility so low when implied volatility (as measured by the VIX) has been trending higher. Historical volatility often makes lows when the market is making new highs and participants are getting complacent. The study below is from the 5/16/12 letter and it looks at repeated instances of 20-day lows in HV without price highs.

20-day Historical Volatility makes a 20-day low for at least the 3 <sup>rd</sup> time in the last 10 days. SPX has 0 20-day highs in the last 10 days. 20-day HV is below its 100ma. Buy on close. Sell X days later. \$100k/trade. 1999 - 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
10	-34,666.53	20	8	12	40.00	1,568.87	3,064.50	-3,934.79	-9,248.46	0.40	0.27	-1,733.33
9	-32,360.44	20	7	13	35.00	1,670.30	3,454.95	-3,388.66	-5,844.30	0.49	0.27	-1,618.02
8	-45,478.62	22	6	16	27.27	1,164.64	2,137.74	-3,279.15	-7,573.44	0.36	0.13	-2,067.21
7	-35,051.97	23	7	16	30.43	982.53	2,155.50	-2,620.60	-5,959.52	0.37	0.16	-1,524.00
6	-29,186.56	23	7	16	30.43	1,154.74	2,135.70	-2,329.36	-5,678.64	0.50	0.22	-1,268.98
5	-33,704.36	24	7	17	29.17	823.24	2,277.90	-2,321.59	-4,943.40	0.35	0.15	-1,404.35
4	-19,645.30	26	9	17	34.62	1,668.98	3,291.12	-2,039.19	-5,769.55	0.82	0.43	-755.59
3	-20,472.61	28	9	19	32.14	1,654.71	2,634.92	-1,861.32	-4,463.68	0.89	0.42	-731.16
2	-15,367.83	35	16	19	45.71	927.52	2,957.13	-1,589.90	-3,551.76	0.58	0.49	-439.08
1	-10,533.51	47	20	27	42.55	977.64	2,861.10	-1,114.31	-3,006.10	0.88	0.65	-224.12

The stats all suggest a downside edge. Below is a profit curve using a 5-day exit strategy. This was the most appealing curve.



The downside edge has been steady. This serves as confirmation of the bearish tendency.

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



With tonight's study factored in the green Aggregator Line sunk below 0. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line is also still positive. This means the SPX is oversold versus recent expectations. So net expectations are bearish but the SPX is already oversold. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. This led the Aggregator to change from long to flat 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 negative on Thursday. Of course this could change if more bullish evidence emerges. The Differential Pivot will be 1,413.27 on Thursday. This is 0.7% above Wednesday's close. So it would take a close higher of at least this much in order to push the SPX into overbought territory.

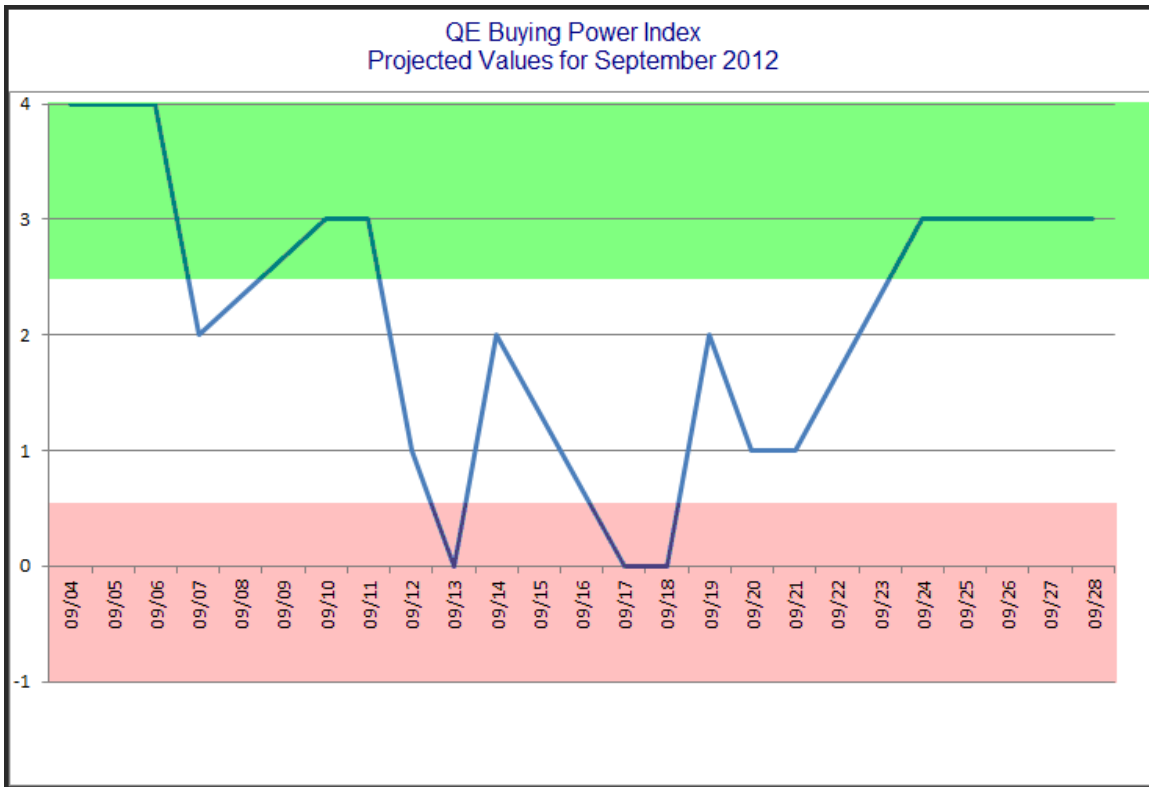
The study tonight offers fairly compelling evidence of a downside edge, and it easily turned expectations negative. Personally, I'm not completely convinced. The bounce thus far has been fairly weak. With so much short-term liquidity pumping, it would be highly unusual not to see at least a little bit more of bounce. I think we are still likely to see some upside continuation over the next day or so before perhaps rolling over. That said, I've learned over the years that basing decisions on my indicators and studies has served me better than holding on to stubborn opinions. So I will look to exit the SPY position tomorrow, but I won't chase a gap down - at least initially.

I'm not going to rush out of the XIV position. Contango remains very strong, and the VIX is still 6% above its 10-day moving average. I don't intend to be stubborn here though, either. If the market does get a pop higher, I'll take relatively quick profits. September is looking more and more ripe for at least a moderate pullback. In addition to the bearish evidence we've seen tonight, a liquidity contraction is set to begin starting Friday and continuing over the next couple of weeks. I discussed this liquidity contraction Sunday night in the intermediate-term outlook, which can be found below.

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

For the 2<sup>nd</sup> 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.



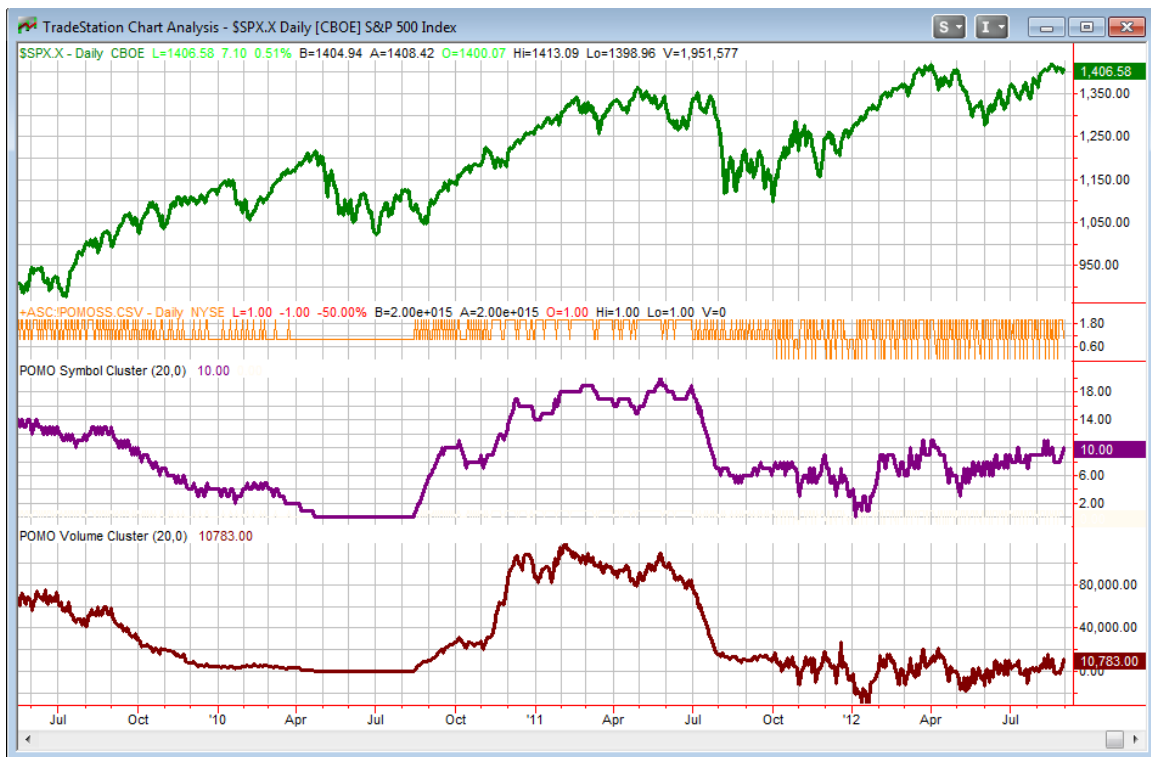
There appear to be 3 distinct periods to keep an eye on in September. The early part of the month is showing strongly positive flows. We could see the market rally during this time. During the middle of the month POMO flows will be negative. If we are going to see a selloff during September, this would 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 7<sup>th</sup> – 20<sup>th</sup> there will be net selling of over \$13 billion. Finally, between the 21<sup>st</sup> – 30<sup>th</sup> 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 3<sup>rd</sup> 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](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***

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.*

*None tonight.*

### **Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
XIV(1/2)	8/28/2012	\$13.88	\$14.39	3.67%	\$13.88	sell on SPX close>1,413.26
SPY(1/4)	8/31/2012	\$140.49	\$140.91	0.30%		sell @ \$140.91 limit

*XIV - I put in a breakeven stop on this one. Also, should we get a pop higher tomorrow I will look to take profits. There is also a chance I may send out an intraday update suggesting an exit at the close. Friday's employment report could bring about some volatility, and depending on how things go tomorrow I may just decide to take profits ahead of that.*

*SPY - I will sell into a gap up, or place a limit at yesterday's closing level if SPY gaps down. If I am not filled within the first 30 min. of trading, I will likely send out an intraday update where I will place a stop below the low of the first 30 min. or so.*

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