

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 7, 2012

Volume 5 Issue 173

Market Overview



Signals Overview

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

Tonight's Research Points

- Thursday's breakout occurred in a way that often suggests further upside. Positives included 1) an unfilled upside gap, 2) extremely strong breadth, and 3) extremely strong volume.
- The low VIX:VXV ratio suggests increased risk when at a 50-day high.

Short-term Outlook

The Bottom Line

The breakout looks good, but it left the market strongly overbought. Liquidity will begin contracting over the next few weeks. It seems like a good time to take profits. I'm flat.

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

| Study Date | Description | Time span | Bias | Avg Max Move |
|---------------------------|--|-----------------|----------------|--------------|
| Active | | | | |
| September 7, 2012 | SPX 50-high. VIX:VXV < 0.85 | 1-4 days | Bearish | |
| September 7, 2012 | 50-high break strong breadth & vol | 1-5 days | Bullish | |
| September 7, 2012 | Breakout with unfilled gap up | 1-5 days | Bullish | |
| September 6, 2012 | 20-day HV 20-day lows. No 20-hi SPX | 1-5 days | Bearish | -2.60% |
| 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% |
| Active - Long Term | | | | |
| 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 | |
| Dropped Tonight | | | | |
| September 5, 2012 | SPX down. NYSE Up Issues % > 55% | 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

New out of Europe provided the spark and flush liquidity provided the fuel. The result was a strong burst higher on Thursday. MThe SPX and Russell 2000 each rallied 2.0%, while the NASDAQ rose 2.2%. Breadth was extremely positive as the NYSE Up Issues % was 78% and Up Volume % came in at 93%. Total NYSE volume hit its highest level in over a month.

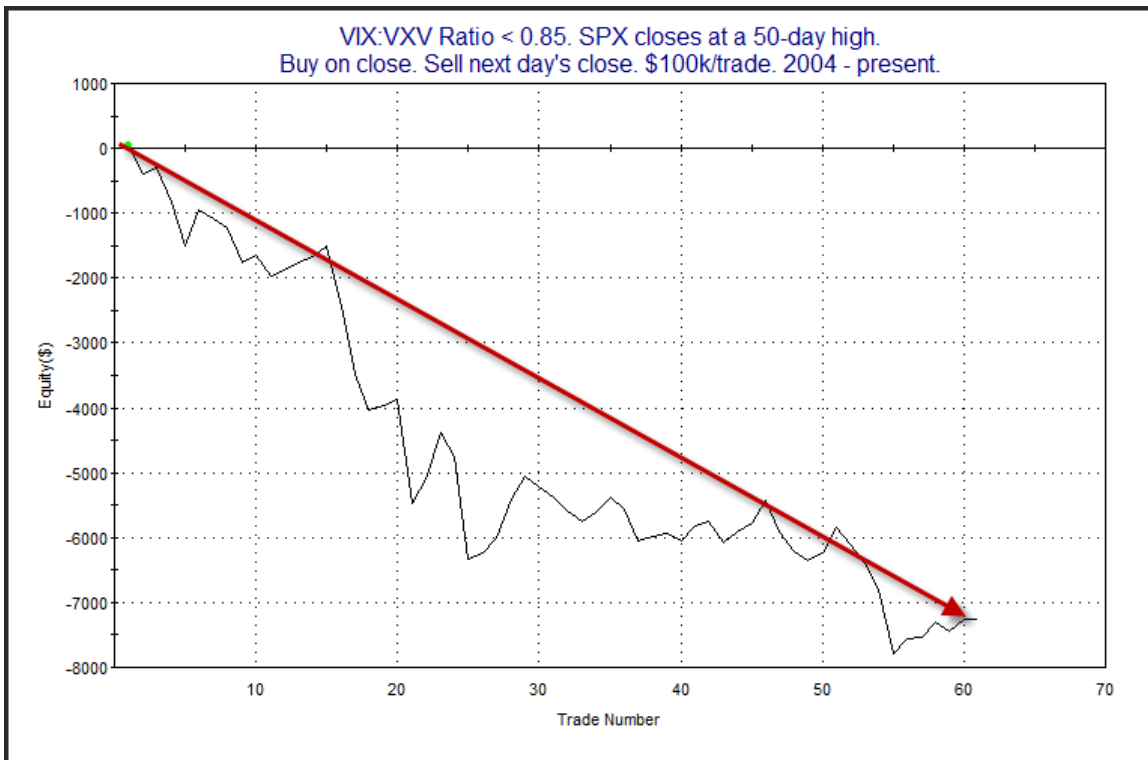
All this triggered a large number of studies in the Quantifinder, most of which were bullish. Before getting to the bullish ones, I thought I would show the lone bearish study.

It was last seen in the 8/20/12 letter and considers what happens when the SPX is hitting a new 50 day high while the VIX:VXV ratio is very low. For those that are unfamiliar, VIX is a measure of expected 1-month volatility and VXV is a measure of expected 3-month volatility. A very low VIX:VXV ratio suggests that option traders expect to see a rise in volatility in the coming months. Said another way, short-term event risk is perceived as very low right now in comparison to longer-term systematic risk. When the ratio gets especially low it suggests there is a decent chance that short-term risk is being underestimated. The study below considers the impact of a low ratio at a new market high.

VIX:VXV Ratio < 0.85. SPX closes at a 50-day high.
Buy on close. Sell next day's close. \$100k/trade. 2004 - present.

| TradeStation Performance Summary Collapse ^ | | | |
|--|--------------|--------------------------|---------------|
| All Trades | | | |
| Total Net Profit | (\$7,251.91) | Profit Factor | 0.47 |
| Gross Profit | \$6,383.80 | Gross Loss | (\$13,635.71) |
| Total Number of Trades | 61 | Percent Profitable | 50.82% |
| Winning Trades | 31 | Losing Trades | 30 |
| Even Trades | 0 | | |
| Avg. Trade Net Profit | (\$118.88) | Ratio Avg. Win:Avg. Loss | 0.45 |
| Avg. Winning Trade | \$205.93 | Avg. Losing Trade | (\$454.52) |
| Largest Winning Trade | \$708.05 | Largest Losing Trade | (\$1,602.28) |

The odds are 50/50 but the losers have been more than twice the size of the winners. This suggests the complacency we are seeing at these high levels is more likely to lead to a big down day than be followed by a big up day. To see how the edge has played out over time I have posted the profit curve below.



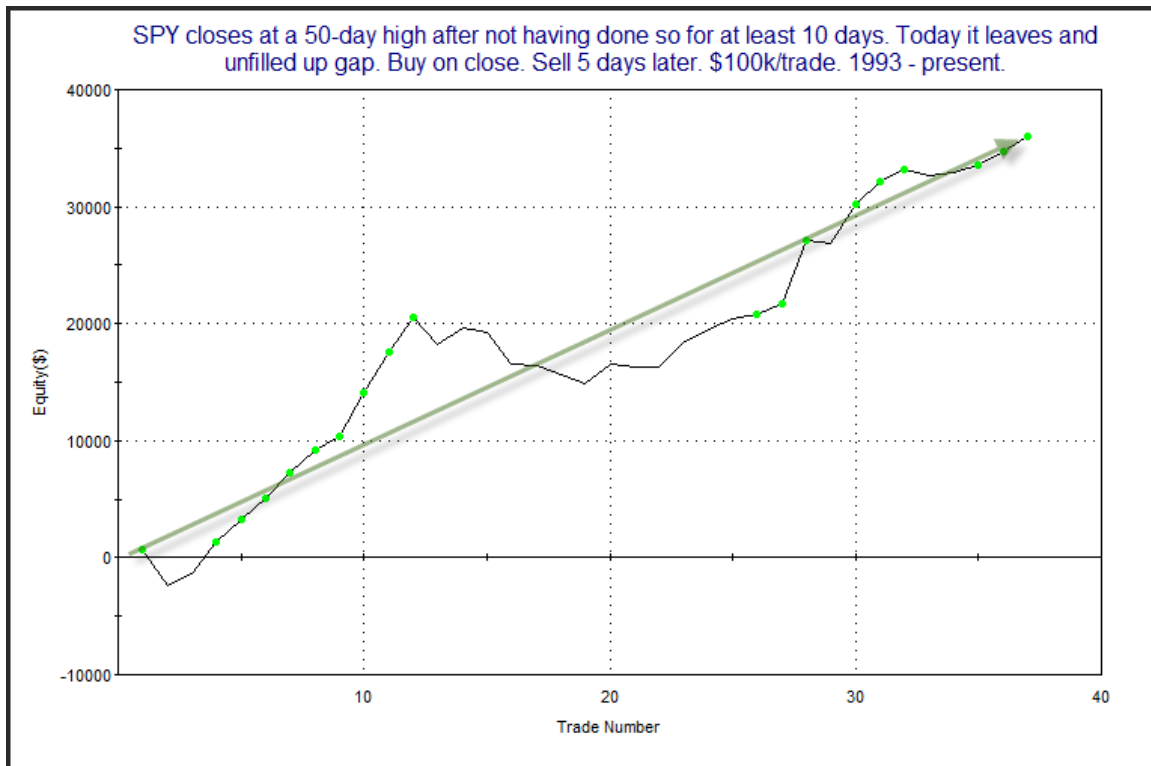
The equity curve has certainly been choppy but it has managed to maintain a downward trajectory throughout.

But the strong move up led to a new 50-day high and a breakout of the recent range. There were several positives associated with this breakout.

In the 1/11/12 subscriber letter I looked at the importance of an unfilled upside gap. I have revisited that study below.

| SPY closes at a 50-day high after not having done so for at least 10 days. Today it leaves and unfilled up gap. 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 | 35,985.29 | 37 | 27 | 10 | 72.97 | 1,748.04 | 5,434.00 | -1,121.18 | -3,093.12 | 1.56 | 4.21 | 972.58 |
| 4 | 24,192.62 | 37 | 27 | 10 | 72.97 | 1,356.49 | 3,637.92 | -1,243.27 | -3,267.84 | 1.09 | 2.95 | 653.85 |
| 3 | 20,128.70 | 37 | 26 | 11 | 70.27 | 1,251.61 | 3,992.56 | -1,128.46 | -2,538.18 | 1.11 | 2.62 | 544.02 |
| 2 | 14,195.98 | 37 | 26 | 11 | 70.27 | 871.08 | 2,545.92 | -768.37 | -2,293.20 | 1.13 | 2.68 | 383.68 |
| 1 | 3,782.23 | 37 | 26 | 11 | 70.27 | 534.72 | 1,816.10 | -920.04 | -2,591.68 | 0.58 | 1.37 | 102.22 |
| 33 of 37 instances (89%) closed above the entry price at some point in the next 4 days. | | | | | | | | | | | | |

Results here are strong across the board. Below is an equity curve using a 5-day holding period.



The nice upslope on the equity curve confirms the bullish inclinations.

Technicians will often use the term “breakaway gap”. This suggests the gap occurs on the same day as a base breakout. The idea is that the new high causes excitement and the gap leaves a good amount of people sidelined or stuck short. When it doesn’t immediately fill, it leads these people to chase and helps to propel the market even higher.

Now let’s look at instances where the 50-day high breakout was not accompanied by an unfilled gap. Interestingly, the number of instances was nearly the same. This study also appeared in the 1/11/12 Letter and is updated.

SPY closes at a 50-day high after not having done so for at least 10 days. No unfilled gap today.
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 | 3.13 | 38 | 22 | 16 | 57.89 | 1,035.77 | 2,671.20 | -1,423.99 | -4,285.26 | 0.73 | 1.00 | 0.08 |
| 4 | -3,699.03 | 38 | 19 | 19 | 50.00 | 1,081.98 | 2,072.07 | -1,276.67 | -4,518.34 | 0.85 | 0.85 | -97.34 |
| 3 | 1,615.79 | 38 | 20 | 18 | 52.63 | 1,091.84 | 2,927.90 | -1,123.39 | -5,133.72 | 0.97 | 1.08 | 42.52 |
| 2 | -2,200.67 | 38 | 18 | 20 | 47.37 | 700.55 | 2,324.90 | -740.53 | -3,640.86 | 0.95 | 0.85 | -57.91 |
| 1 | 657.06 | 38 | 20 | 17 | 52.63 | 475.49 | 1,586.97 | -520.75 | -2,448.72 | 0.91 | 1.07 | 17.29 |

As you can see these moves to new highs that don't start with an unfilled gap are much less reliable.

The unfilled gap wasn't the only positive associated with Thursday's breakout. The strong breadth was also a plus. In the 9/21/10 subscriber letter I looked at other breakouts that came on strong breadth. I have updated that study below.

SPX closes at a 50-day high after not having done so for at least 10 days.
NYSE Up Volume > 90%. Buy SPX on close. Sell X days later. \$100k/trade. 1970 - 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 |
|--------|-----------------|-------------------|---------------------|--------------------|-------------------|------------------------|------------------------|-----------------------|-----------------------|----------------------|-------------------|----------------|
| 50 | 66,430.92 | 9 | 9 | 0 | 100.00 | 7,381.21 | 19,845.80 | 0.00 | 0.00 | 100.00 | 100.00 | 7,381.21 |
| 45 | 66,553.86 | 9 | 9 | 0 | 100.00 | 7,394.87 | 17,945.20 | 0.00 | 0.00 | 100.00 | 100.00 | 7,394.87 |
| 40 | 65,740.26 | 9 | 9 | 0 | 100.00 | 7,304.47 | 20,950.80 | 0.00 | 0.00 | 100.00 | 100.00 | 7,304.47 |
| 35 | 64,480.56 | 9 | 9 | 0 | 100.00 | 7,164.51 | 18,961.80 | 0.00 | 0.00 | 100.00 | 100.00 | 7,164.51 |
| 30 | 55,141.04 | 11 | 10 | 1 | 90.91 | 5,555.99 | 11,920.74 | -418.88 | -418.88 | 13.26 | 132.64 | 5,012.82 |
| 25 | 50,882.44 | 12 | 10 | 2 | 83.33 | 5,654.38 | 12,045.67 | -2,830.68 | -2,993.76 | 2.00 | 9.99 | 4,240.20 |
| 20 | 42,760.00 | 12 | 8 | 4 | 66.67 | 6,707.94 | 13,393.77 | -2,725.88 | -6,770.72 | 2.46 | 4.92 | 3,563.33 |
| 15 | 35,503.73 | 12 | 8 | 4 | 66.67 | 5,725.85 | 8,150.48 | -2,575.76 | -5,148.00 | 2.22 | 4.45 | 2,958.64 |
| 10 | 30,511.05 | 12 | 8 | 4 | 66.67 | 4,657.74 | 10,507.25 | -1,687.73 | -4,090.24 | 2.76 | 5.52 | 2,542.59 |
| 9 | 26,012.43 | 12 | 8 | 3 | 66.67 | 4,078.11 | 8,413.73 | -2,204.14 | -4,101.68 | 1.85 | 4.93 | 2,167.70 |
| 8 | 22,586.77 | 12 | 8 | 4 | 66.67 | 3,968.24 | 8,524.75 | -2,289.78 | -3,923.40 | 1.73 | 3.47 | 1,882.23 |
| 7 | 23,037.77 | 12 | 9 | 3 | 75.00 | 3,531.48 | 6,026.80 | -2,915.19 | -3,954.60 | 1.21 | 3.63 | 1,919.81 |
| 6 | 21,606.85 | 12 | 9 | 3 | 75.00 | 3,054.73 | 6,819.80 | -1,961.90 | -4,106.70 | 1.56 | 4.67 | 1,800.57 |
| 5 | 24,939.76 | 12 | 9 | 3 | 75.00 | 3,173.64 | 8,516.82 | -1,207.67 | -3,295.50 | 2.63 | 7.88 | 2,078.31 |
| 4 | 17,599.23 | 12 | 9 | 3 | 75.00 | 2,606.68 | 6,716.71 | -1,953.62 | -4,894.50 | 1.33 | 4.00 | 1,466.60 |
| 3 | 20,150.86 | 12 | 9 | 3 | 75.00 | 2,432.15 | 6,740.50 | -579.49 | -1,555.56 | 4.20 | 12.59 | 1,679.24 |
| 2 | 17,198.17 | 12 | 11 | 1 | 91.67 | 1,630.14 | 4,028.44 | -733.41 | -733.41 | 2.22 | 24.45 | 1,433.18 |
| 1 | 11,462.99 | 12 | 9 | 3 | 75.00 | 1,362.43 | 2,755.52 | -266.30 | -475.20 | 5.12 | 15.35 | 955.25 |

While such breakout action has been unusual, both short and long-term performance has been impressive. But even if we ignore the fresh breakouts, and simply look at instances of SPX hitting a 50-day high on 90% up volume, the stats are still quite impressive. The

study below was last seen just a month ago in the 8/6/12 subscriber letter. Stats are updated.

| SPX closes at a 50-day high. NYSE Up Volume > 90%. Buy SPX on close. Sell X days later. \$100k/trade. 1970 - 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 |
| 50 | 87,196.79 | 17 | 16 | 1 | 94.12 | 5,791.93 | 19,845.80 | -5,474.10 | -5,474.10 | 1.06 | 16.93 | 5,129.22 |
| 45 | 85,183.93 | 18 | 16 | 2 | 88.89 | 5,830.07 | 17,945.20 | -4,048.58 | -5,052.36 | 1.44 | 11.52 | 4,732.44 |
| 40 | 83,320.36 | 19 | 15 | 4 | 78.95 | 5,989.19 | 20,950.80 | -1,629.39 | -2,937.98 | 3.68 | 13.78 | 4,385.28 |
| 35 | 86,607.69 | 19 | 16 | 3 | 84.21 | 5,695.52 | 18,961.80 | -1,506.89 | -2,194.86 | 3.78 | 20.16 | 4,558.30 |
| 30 | 74,210.36 | 19 | 17 | 2 | 89.47 | 4,411.97 | 11,920.74 | -396.52 | -418.88 | 11.13 | 94.58 | 3,905.81 |
| 25 | 64,737.87 | 21 | 16 | 5 | 76.19 | 4,670.71 | 12,045.67 | -1,998.68 | -3,024.54 | 2.34 | 7.48 | 3,082.76 |
| 20 | 58,803.67 | 22 | 16 | 6 | 72.73 | 4,654.12 | 13,393.77 | -2,610.37 | -6,770.72 | 1.78 | 4.75 | 2,672.89 |
| 15 | 50,114.95 | 22 | 17 | 5 | 77.27 | 3,923.24 | 8,150.48 | -3,316.01 | -6,277.02 | 1.18 | 4.02 | 2,277.95 |
| 10 | 33,393.72 | 24 | 15 | 9 | 62.50 | 3,263.16 | 10,507.25 | -1,728.18 | -4,090.24 | 1.89 | 3.15 | 1,391.40 |
| 9 | 28,463.36 | 24 | 16 | 7 | 66.67 | 2,846.31 | 8,413.73 | -2,439.66 | -5,207.55 | 1.17 | 2.67 | 1,185.97 |
| 8 | 28,439.04 | 24 | 16 | 8 | 66.67 | 2,942.48 | 8,524.75 | -2,330.07 | -4,082.16 | 1.26 | 2.53 | 1,184.96 |
| 7 | 26,187.46 | 25 | 16 | 9 | 64.00 | 2,848.23 | 6,026.80 | -2,153.79 | -3,954.60 | 1.32 | 2.35 | 1,047.50 |
| 6 | 26,565.22 | 25 | 17 | 8 | 68.00 | 2,231.22 | 6,819.80 | -1,420.68 | -4,106.70 | 1.57 | 3.34 | 1,062.61 |
| 5 | 30,625.98 | 27 | 21 | 6 | 77.78 | 1,824.06 | 8,516.82 | -1,279.87 | -3,295.50 | 1.43 | 4.99 | 1,134.30 |
| 4 | 22,758.92 | 28 | 21 | 7 | 75.00 | 1,715.41 | 6,716.71 | -1,894.95 | -4,894.50 | 0.91 | 2.72 | 812.82 |
| 3 | 15,642.25 | 28 | 18 | 10 | 64.29 | 1,538.77 | 6,740.50 | -1,205.57 | -5,105.87 | 1.28 | 2.30 | 558.65 |
| 2 | 17,475.50 | 28 | 20 | 8 | 71.43 | 1,138.89 | 4,028.44 | -662.77 | -2,409.33 | 1.72 | 4.30 | 624.13 |
| 1 | 11,034.90 | 29 | 16 | 13 | 55.17 | 996.01 | 2,755.52 | -377.02 | -1,255.50 | 2.64 | 3.25 | 380.51 |

No matter how you look at it, the extremely strong breadth in conjunction with the 50-day high appears to suggest a sizable upside edge.

There were some studies that suggested lower volume is typically preferable to rising volume on these breakouts. I looked at increasing volume days like today a little more closely. I decided to break it out to see occurrences like Thursday's, where volume was extremely strong and reached a 20-day high. I then looked at a more moderate rise in volume. This first study shows times like now where the breakout occurred on extreme volume (and the volume was not attributable to it being op-ex Friday).

SPX closes at a 20-day high after not having done so for at least 10 days. Close >200ma.
NYSE volume is the highest in 20-days. It is not op-ex Friday.
 Buy SPX 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 |
|--------|-----------------|-------------------|---------------------|--------------------|-------------------|------------------------|------------------------|-----------------------|-----------------------|----------------------|-------------------|----------------|
| 10 | 23,913.43 | 11 | 10 | 1 | 90.91 | 2,476.97 | 4,885.00 | -856.26 | -856.26 | 2.89 | 28.93 | 2,173.95 |
| 9 | 25,045.10 | 11 | 11 | 0 | 100.00 | 2,276.83 | 5,451.25 | 0.00 | 0.00 | 100.00 | 100.00 | 2,276.83 |
| 8 | 21,240.96 | 11 | 9 | 2 | 81.82 | 2,415.03 | 3,842.50 | -247.17 | -450.24 | 9.77 | 43.97 | 1,931.00 |
| 7 | 19,695.44 | 11 | 9 | 2 | 81.82 | 2,336.78 | 4,443.12 | -667.79 | -811.65 | 3.50 | 15.75 | 1,790.49 |
| 6 | 16,646.32 | 11 | 9 | 2 | 81.82 | 2,095.84 | 4,698.80 | -1,108.11 | -2,094.42 | 1.89 | 8.51 | 1,513.30 |
| 5 | 17,165.15 | 11 | 9 | 2 | 81.82 | 2,077.00 | 4,683.84 | -763.91 | -1,360.77 | 2.72 | 12.24 | 1,560.47 |
| 4 | 14,649.84 | 11 | 9 | 2 | 81.82 | 1,758.55 | 4,518.75 | -588.55 | -1,043.86 | 2.99 | 13.45 | 1,331.80 |
| 3 | 10,358.05 | 11 | 9 | 2 | 81.82 | 1,346.93 | 2,403.80 | -882.17 | -1,369.04 | 1.53 | 6.87 | 941.64 |
| 2 | 5,518.09 | 11 | 7 | 4 | 63.64 | 1,056.14 | 1,998.39 | -468.73 | -1,301.14 | 2.25 | 3.94 | 501.64 |
| 1 | 8,481.19 | 11 | 9 | 2 | 81.82 | 1,044.84 | 1,606.89 | -461.21 | -645.21 | 2.27 | 10.19 | 771.02 |

Instances are a bit low, and returns aren't quite as impressive as the extreme breadth study above, but 11 for 11 nine days out helps provide confidence that the big volume spike is not a problem. The next study shows what happens if volume rose but was more moderate.

SPX closes at a 20-day high after not having done so for at least 10 days. Close >200ma.
NYSE volume is higher than yesterday but < a 20-day high. It is not op-ex Friday.
 Buy SPX 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 |
|--------|-----------------|-------------------|---------------------|--------------------|-------------------|------------------------|------------------------|-----------------------|-----------------------|----------------------|-------------------|----------------|
| 10 | -2,396.36 | 39 | 19 | 20 | 48.72 | 1,612.99 | 4,544.29 | -1,652.16 | -4,162.56 | 0.98 | 0.93 | -61.45 |
| 9 | 1,116.90 | 39 | 18 | 21 | 46.15 | 1,455.89 | 5,022.58 | -1,194.72 | -2,858.55 | 1.22 | 1.04 | 28.64 |
| 8 | -4,312.46 | 39 | 21 | 18 | 53.85 | 1,183.32 | 5,296.50 | -1,620.12 | -4,375.02 | 0.73 | 0.85 | -110.58 |
| 7 | -3,892.36 | 39 | 17 | 22 | 43.59 | 1,389.35 | 4,984.06 | -1,250.51 | -4,953.00 | 1.11 | 0.86 | -99.80 |
| 6 | -1,643.95 | 39 | 19 | 20 | 48.72 | 1,242.64 | 4,666.27 | -1,262.71 | -4,512.96 | 0.98 | 0.93 | -42.15 |
| 5 | -9,211.61 | 39 | 16 | 23 | 41.03 | 921.90 | 2,288.73 | -1,041.83 | -3,651.84 | 0.88 | 0.62 | -236.20 |
| 4 | -10,766.21 | 39 | 16 | 23 | 41.03 | 1,047.17 | 2,443.50 | -1,196.56 | -4,419.36 | 0.88 | 0.61 | -276.06 |
| 3 | -1,370.88 | 39 | 21 | 18 | 53.85 | 892.02 | 2,074.32 | -1,116.85 | -4,159.44 | 0.80 | 0.93 | -35.15 |
| 2 | -1,147.82 | 39 | 23 | 16 | 58.97 | 594.32 | 1,718.79 | -926.07 | -2,413.44 | 0.64 | 0.92 | -29.43 |
| 1 | 3,007.83 | 39 | 23 | 16 | 58.97 | 473.72 | 1,496.78 | -492.99 | -1,424.16 | 0.96 | 1.38 | 77.12 |

The news here would not have been good. Moderate volume rises on these breakouts don't appear to provide a substantial edge for either longs or shorts.

Bottom line is that the breakout today was impressive, and it occurred in such a manner that suggests both short and long-term follow through is likely.

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



With tonight's studies factored in the green Aggregator Line shot back above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line took a dive below zero. This means the SPX is overbought versus recent expectations. So net expectations are bullish but the SPX is already overbought. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. This lead the Aggregator to remain 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 positive on Friday. Of course this could change if more bearish evidence emerges. The Differential Pivot will be 1,411.30 on Friday. This is 1.5% below Thursday's close. So it would take a close lower of at least this much in order to push the SPX into oversold territory. That's a tall order for a one day drop. A more likely scenario would be a multi-day pullback or consolidation to move SPX out of overbought territory.

The Aggregator and the QE Buying Power Swing System both changed to flat today. I also got flat at the close. Unfortunately, by exiting the SPY position on the open, I did

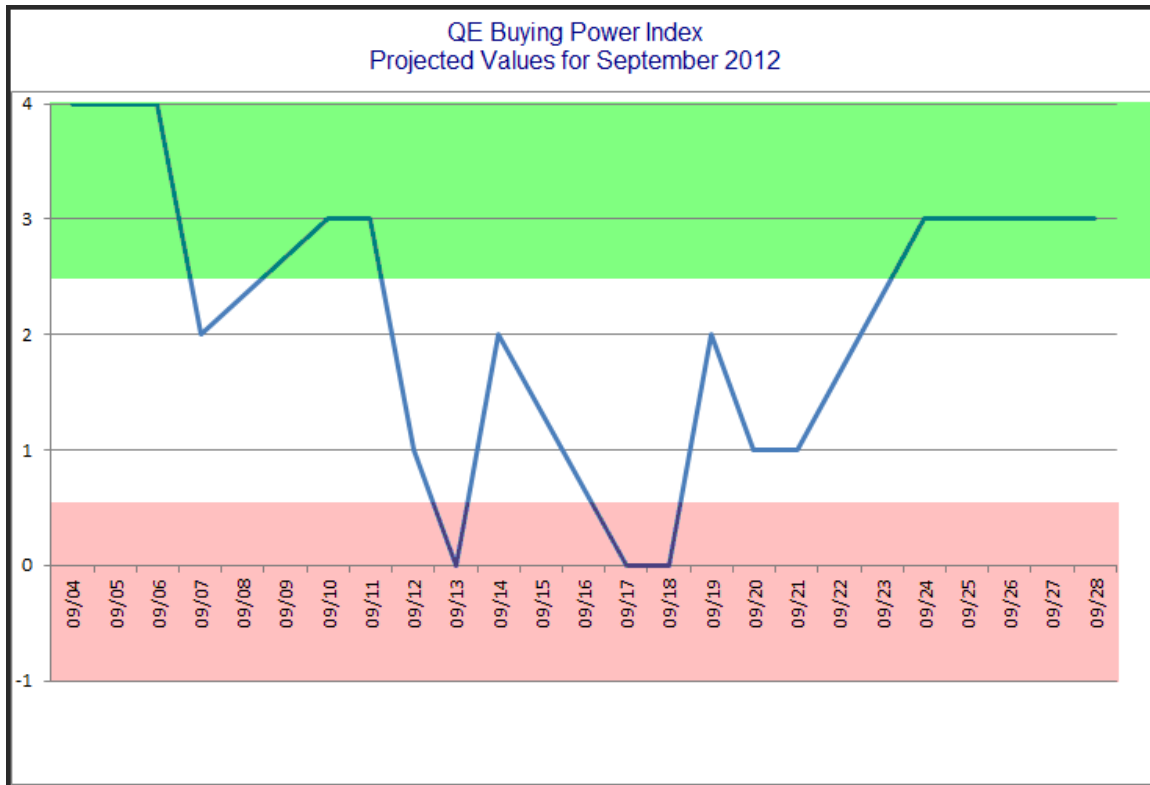
miss out on a good portion of Thursday's rally. Fortunately, I decided last night not to rush out of the XIV position, but rather only sell at the close if the market put in a good rally on Thursday. That rally arrived in a big way and it really jacked up the price of XIV, making for a very substantial short-term gain on that one. While evidence is pointing higher at the moment, the market is now quite overbought. I'd prefer to wait for a pullback or at least a tight consolidation before taking another shot at the long side.

One additional note on the QE Buying Power Index. I believe the market being flush with liquidity really helped aid the pop higher Thursday. Friday is a POMO selling day and it begins a 2+ week liquidity contraction. I've been pointing to this part of the month as one that seems most likely to suffer correction. While tonight's evidence was strong, and we may get more evidence suggesting continued upside, this will soon become a liquidity environment that I will view with great caution.

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.

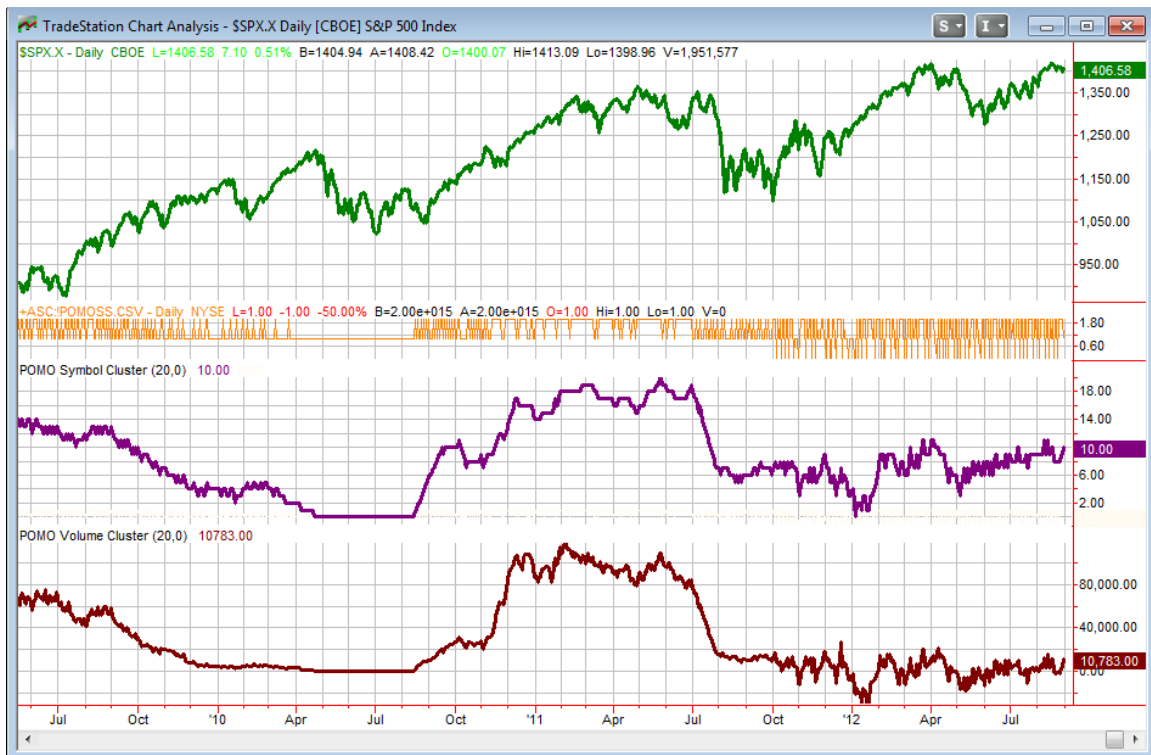
On a net basis September is expected to see \$45 billion in buying and \$38 billion in selling. The \$7 billion difference would mean the largest monthly liquidity infusion since Operation Twist began last October, topping the \$6 billion of July and August. As I mentioned above it is front and back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

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 | \$15.90 | 14.55% | \$13.88 | <i>sold on close</i> |
| SPY(1/4) | 8/31/2012 | \$140.49 | \$141.76 | 0.90% | | <i>sold on open</i> |
| | | | | | | |
| | | | | | | |
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