

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 24, 2012

Volume 5 Issue 184

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- The week after September Op-ex has historically been the worst of the year.
- The SPX down close on solid breadth suggests a short-term upside edge.
- More QE3 details are discussed.

## Short-term Outlook

### The Bottom Line

The Aggregator is suggesting a very slight downside edge. Risk appears high though and I am not interested at this time.

## 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 24, 2012	SPX dn. Up Issues > 55%	1-3 days	Bullish	
September 24, 2012	Weakest week	1-4 days	Bearish	
September 21, 2012	Up 2 days but < 3 ago	1-2 days	Bullish	
September 18, 2012	SPY unfilled gap up then down from 20h	1-7 days	Bearish	-2.40%
September 14, 2012	100 day high on Fed Day	1-8 days	Bullish	1.90%
<b>Active - Long Term</b>				
September 17, 2012	QE3	int term	Bullish	
September 17, 2012	SPX and TNX hit 50-day high	1-20 days	Bearish	
September 11, 2012	Key Reversal from high	1-12 days	Bullish	
August 20, 2012	Nasdaq leading SPX	int term	Bullish	
July 30, 2012	SPX 50-day high on 90% up vol	1-50 days	Bullish	
February 1, 2012	Golden Cross	int term	Bullish	
<b>Dropped Tonight</b>				
September 21, 2012	Up < 0.25% Top 10% Range	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

Friday started with a strong gap up, but then it was a slow fade for most of the day, and the indices finished mixed. The SPX fell a mere 0.01% while the NASDAQ rose 0.1%, and the Russell 2000 gained 0.5%. Breadth was mixed as the NYSE Up Issues % was 58% but the Up Volume % came in just under 50%. Total NYSE volume was up sharply with options expiration.

There was also a mix with regards to the studies tonight. From a seasonality standpoint, there isn't a more reliable time of the year to have a pullback. Since 1961 the week following the 3<sup>rd</sup> Friday in September has produced the most bearish results of any week. In the 9/19/11 subscriber letter I showed a table with the best and worst weeks of the year. I have copied that table below (not updated).

SPX weekly performance for based on the month specified after the Friday specified. \$100/trade. 1961 - present. Top 10 and bottom 10 results shown.												
	Month	Friday	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
1	1	4	44,281.46	51	32	19	62.75	2,136.95	-1,268.47	1.68	2.84	868.26
2	10	4	37,751.45	50	30	20	60.00	2,392.76	-1,701.57	1.41	2.11	755.03
3	4	2	38,178.96	51	34	17	66.67	1,850.76	-1,455.70	1.27	2.54	748.61
4	12	4	31,017.69	50	33	17	66.00	1,527.89	-1,141.33	1.34	2.60	620.35
5	5	4	31,197.20	51	30	21	58.82	1,923.02	-1,261.59	1.52	2.18	611.71
6	9	2	30,489.61	50	33	17	66.00	1,761.56	-1,626.00	1.08	2.10	609.79
7	3	2	29,612.21	51	31	20	60.78	1,738.98	-1,214.81	1.43	2.22	580.63
8	11	3	24,800.52	50	31	19	62.00	1,656.75	-1,397.83	1.19	1.93	496.01
9	12	2	23,755.31	50	31	19	62.00	1,278.66	-835.95	1.53	2.50	475.11
10	3	1	21,475.12	51	29	22	56.86	1,619.76	-1,158.99	1.40	1.84	421.08
39	5	1	-6,326.00	51	20	31	39.22	1,561.68	-1,211.60	1.29	0.83	-124.04
40	7	3	-8,030.71	51	26	25	50.98	1,562.52	-1,946.25	0.80	0.83	-157.46
41	1	3	-8,261.87	51	27	24	52.94	1,292.71	-1,798.54	0.72	0.81	-162.00
42	6	2	-8,362.71	51	26	24	50.98	1,472.70	-1,943.87	0.76	0.82	-163.97
43	2	3	-10,968.16	51	23	28	45.10	1,125.88	-1,316.55	0.86	0.70	-215.06
44	5	3	-14,282.67	51	26	25	50.98	1,191.03	-1,809.98	0.66	0.68	-280.05
45	9	1	-15,801.61	51	26	25	50.98	1,373.43	-2,060.44	0.67	0.69	-309.84
46	6	3	-21,415.58	51	22	29	43.14	1,186.46	-1,638.54	0.72	0.55	-419.91
47	10	3	-24,660.96	50	21	29	42.00	1,527.57	-1,956.55	0.78	0.57	-493.22
48	9	3	-34,933.53	50	17	33	34.00	1,368.77	-1,763.71	0.78	0.40	-698.67

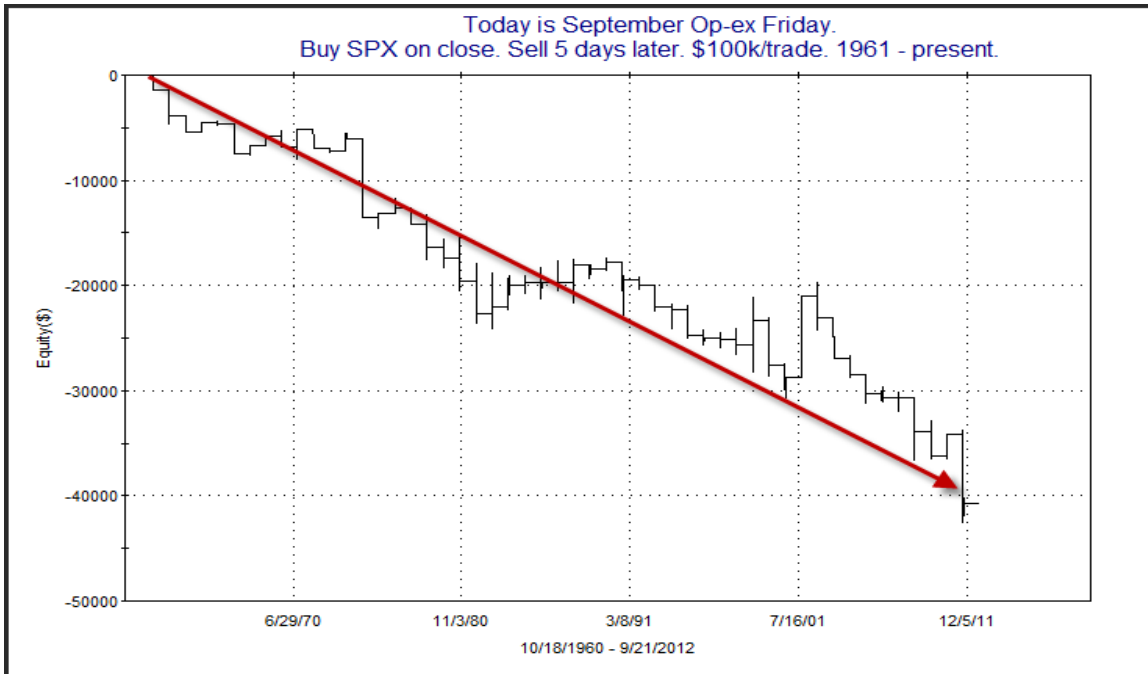
To make it a little neater and to keep the number of instances consistent I did not include weeks after the 5<sup>th</sup> Friday in these results. Just Fridays 1-4. If you look at the bottom line you will see we the worst results occur following the 3<sup>rd</sup> Friday of the 9<sup>th</sup> month. That is this upcoming week. In that letter I also ran the study back to 1988 to get a more recent picture. That table is also copied below (not updated).

SPX weekly performance for based on the month specified after the Friday specified.  
\$100/trade. 1988 - present. Top 10 and bottom 10 results shown.

	Month	Friday	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
1	1	4	28,907.81	24	15	9	62.50	2,611.87	-1,141.13	2.29	3.81	1,204.49
2	10	2	25,191.73	23	16	7	69.57	2,649.36	-2,456.86	1.08	2.46	1,095.29
3	4	2	25,898.15	24	15	9	62.50	2,605.37	-1,464.72	1.78	2.96	1,079.09
4	10	4	23,670.42	23	16	7	69.57	2,368.26	-2,031.67	1.17	2.66	1,029.15
5	5	4	23,818.28	24	16	8	66.67	2,165.64	-1,353.99	1.60	3.20	992.43
6	3	2	18,651.23	24	16	8	66.67	1,987.46	-1,643.52	1.21	2.42	777.13
7	11	3	16,392.83	23	13	10	56.52	1,991.50	-949.66	2.10	2.73	712.73
8	12	2	15,392.92	23	18	5	78.26	1,170.07	-1,133.66	1.03	3.72	669.26
9	9	2	14,940.56	23	16	7	69.57	1,669.50	-1,681.63	0.99	2.27	649.59
10	11	4	14,844.39	23	16	7	69.57	1,379.29	-1,032.04	1.34	3.05	645.41
39	8	1	-5,484.37	24	11	13	45.83	1,302.01	-1,523.58	0.85	0.72	-228.52
40	3	3	-5,765.99	24	7	17	29.17	2,826.00	-1,502.82	1.88	0.77	-240.25
41	6	1	-7,127.90	24	10	14	41.67	1,198.21	-1,365.00	0.88	0.63	-297.00
42	10	3	-7,395.83	23	10	13	43.48	1,765.01	-1,926.61	0.92	0.70	-321.56
43	1	1	-6,450.11	20	11	9	55.00	1,334.09	-2,347.23	0.57	0.69	-322.51
44	2	3	-14,275.58	24	10	14	41.67	847.79	-1,625.25	0.52	0.37	-594.82
45	6	3	-15,413.79	24	8	16	33.33	1,299.68	-1,613.20	0.81	0.40	-642.24
46	1	3	-15,583.99	24	11	13	45.83	1,030.36	-2,070.62	0.50	0.42	-649.33
47	10	1	-15,368.64	23	12	11	52.17	1,861.37	-3,427.74	0.54	0.59	-668.20
48	9	3	-16,065.09	23	5	18	21.74	2,565.25	-1,605.08	1.60	0.44	-698.48

As you can see, looking at the more recent time period the week following the 3<sup>rd</sup> Friday in September is still the worst. Other notable bearish weeks that are coming up include the weeks after the 1<sup>st</sup> and 3<sup>rd</sup> Fridays in October.

I also reproduced a graphic to show how this upcoming week has played out over time. This I DID update tonight.



As you can see the bearish tendency has been pretty consistent over the last 51 years. There was a stretch in the late 80's where there was a series of mild up years. Since 1990 it has been pretty much all downhill. Below is a table showing results of buying Sept. op-ex Friday and then selling X days later from 1990 – 2011.

Today is September Op-ex Friday.  
Buy SPX on close. 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	-22,841.04	22	4	18	18.18	3,062.79	7,739.42	-1,949.57	-6,525.56	1.57	0.35	-1,038.23
4	-24,016.31	22	4	18	18.18	2,287.06	5,439.43	-1,842.48	-7,088.90	1.24	0.28	-1,091.65
3	-16,335.01	22	5	17	22.73	2,100.70	4,508.00	-1,578.74	-5,455.74	1.33	0.39	-742.50
2	-12,555.93	22	7	15	31.82	1,092.14	4,786.41	-1,346.73	-5,283.52	0.81	0.38	-570.72
1	-8,403.32	22	6	16	27.27	1,063.49	3,877.95	-924.02	-3,791.21	1.15	0.43	-381.97

**The only year that did not close below the entry price at some point during the week was 2001.**

The consistency and net results appear quite strong. I note the only instance that didn't post a lower close at some point during the following week was in 2001. And the 9/11 attacks certainly made for unusual circumstances that year.

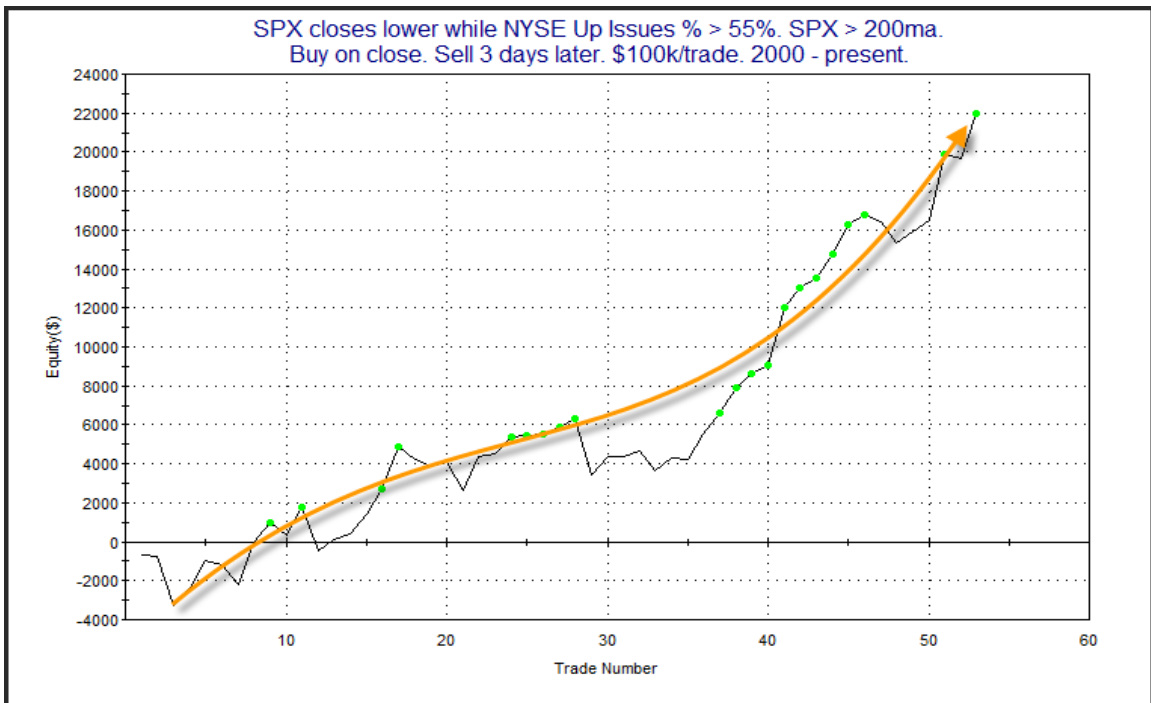
On the bullish side, the study below looks at strong breadth on a day the SPX declines. It appeared just a few weeks ago in the 9/5/12 letter. Results are updated again.

**SPX closes lower while NYSE Up Issues % > 55%. SPX > 200ma.**  
Buy 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	26,665.43	48	28	20	58.33	2,078.50	7,183.08	-1,576.62	-4,406.82	1.32	1.85	555.53
9	29,833.66	48	33	15	68.75	1,801.49	5,597.64	-1,974.36	-4,873.44	0.91	2.01	621.53
8	27,086.08	48	34	14	70.83	1,652.52	5,105.16	-2,078.53	-4,715.80	0.80	1.93	564.29
7	20,041.11	48	33	15	68.75	1,467.62	4,736.88	-1,892.69	-6,585.48	0.78	1.71	417.52
6	16,654.95	49	34	15	69.39	1,376.82	3,398.72	-2,010.45	-9,589.14	0.68	1.55	339.90
5	20,565.12	49	31	18	63.27	1,391.12	3,616.92	-1,253.31	-4,012.80	1.11	1.91	419.70
4	21,753.94	51	32	19	62.75	1,346.11	3,429.00	-1,122.18	-2,921.28	1.20	2.02	426.55
3	22,007.35	53	37	16	69.81	1,012.83	3,373.50	-966.70	-2,852.01	1.05	2.42	415.23
2	19,532.67	54	38	16	70.37	879.27	3,025.12	-867.48	-3,119.03	1.01	2.41	361.72
1	14,510.19	56	34	22	60.71	726.35	2,484.00	-462.99	-1,348.29	1.57	2.42	259.11

**89% of instances posted a close above the entry price at some point in the next week.**

The edge isn't huge, but it does appear to be high-percentage. The equity curve below gives a better idea of how the edge has played out over time.



While the curve certainly appears choppy, the edge has been very strong lately. I believe this study is worth taking into consideration and I've again included it among the active studies.

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



With the new studies tonight the green Aggregator Line remained very slightly below 0. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line dipped just a hair below zero. This means the SPX is “overbought” versus recent expectations. So net expectations are bearish and the SPX is overbought. This is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close below 0. Of course it is almost indiscernible on the chart so this is about as weak of a bearish signal as you can get.

Based on the current open studies, expectations are scheduled to remain negative on Monday. Of course this could easily change if more bullish evidence emerges. The Differential Pivot will near even at 1,460.22 on Monday. This is only 0.07 points above Friday's close. So just about any up close will leave the SPX overbought and any down close will turn it to oversold.

So there is a weak bearish Aggregator signal active right now. I have no interest in following it. Aside from the fact that it is very weak I have 2 additional concerns with it. The first is that liquidity is beginning to flow positive with QE3 purchases and a positive last week of the month of POMO flows expected. I'll discuss this in more detail in the intermediate-term section below.

My second concern is that the 3/10 Offset HV Indicator that I track on the charts remains extremely low at 0.09. I wrote about this in detail in Wednesday night's letter. The bottom line is that the extremely tight volatility we've seen is likely to be followed by a volatility expansion. This means a sharp move could occur in either direction. The threat of a sharp move increases risk. And this increased risk also makes the idea of taking a short here less attractive. For those that missed Wednesday's letter and would like more detail on this indicator I have provided a link below. (*Side note: I mention in the letter that the low reading can suggest a daytrading opportunity using Opening Range Breakout trades. Interestingly, these would have fared well the last 2 days even though the market finished near breakeven. This is because the gaps were fairly large and both filled.*)

#### [2012-09-20 QE Subscriber Letter.pdf](#)

So I am flat and intend to stay there. Perhaps the poor seasonality this week will come into effect. If it does, it could provide a nice buying opportunity as liquidity flows are ramping up. If the market starts to run higher without me then I will likely stay sidelined. The chances of me taking many short positions this early in QE3 are pretty slim. More on QE3 below.

#### ***Intermediate-term Outlook (2 weeks – 2 months)– updated 9/24– bullish***

It was a slight down week for the SPX, but the range was incredibly tight and there was nothing to suggest the uptrend is near its end. More details about QE3 were released and I would like to review them in some detail and discuss the possible impacts this week.

First I will point subscribers to the statement posted on the Fed's website that came along with the QE3 announcement. In it they proclaimed they will be purchasing Agency Mortgage-backed Securities (AMBS) at a pace of about \$40 billion per month. They also stated that would include about \$23 billion for the remainder of September (beginning on the 14<sup>th</sup>). That is roughly \$2 billion / per day.

Here is a link to the statement.

[http://www.newyorkfed.org/markets/opolicy/operating\\_policy\\_120913.html](http://www.newyorkfed.org/markets/opolicy/operating_policy_120913.html)


I've also pasted part of it below with the notes I mentioned highlighted.

**OPERATING POLICY**

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## Statement Regarding Transactions in Agency Mortgage-Backed Securities and Treasury Securities

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September 13, 2012  [Printer version](#)

On September 13, 2012, the Federal Open Market Committee (FOMC) directed the Open Market Trading Desk (the Desk) at the Federal Reserve Bank of New York to **begin purchasing additional agency mortgage-backed securities (MBS) at a pace of \$40 billion per month.** The FOMC also directed the Desk to continue through the end of the year its program to extend the average maturity of its holdings of Treasury securities as announced in June and to maintain its existing policy of reinvesting principal payments from the Federal Reserve's holdings of agency debt and agency MBS in agency MBS.

The FOMC noted that these actions, which together will increase the Committee's holdings of longer-term securities by about \$85 billion each month through the end of the year, should put downward pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative.

**Purchases of Agency MBS**  
The purchases of additional agency MBS will begin tomorrow, and are expected to total approximately **\$23 billion over the remainder of September.** Going forward, details associated with the additional amount of MBS to be purchased each month will be announced on or around the last business day of the prior month.

The Fed has announced the release of an October schedule at 2pm on September 28<sup>th</sup>, which is the same time that the POMO schedule will be released. This is shown on the AMBS schedule page, which is linked to below.

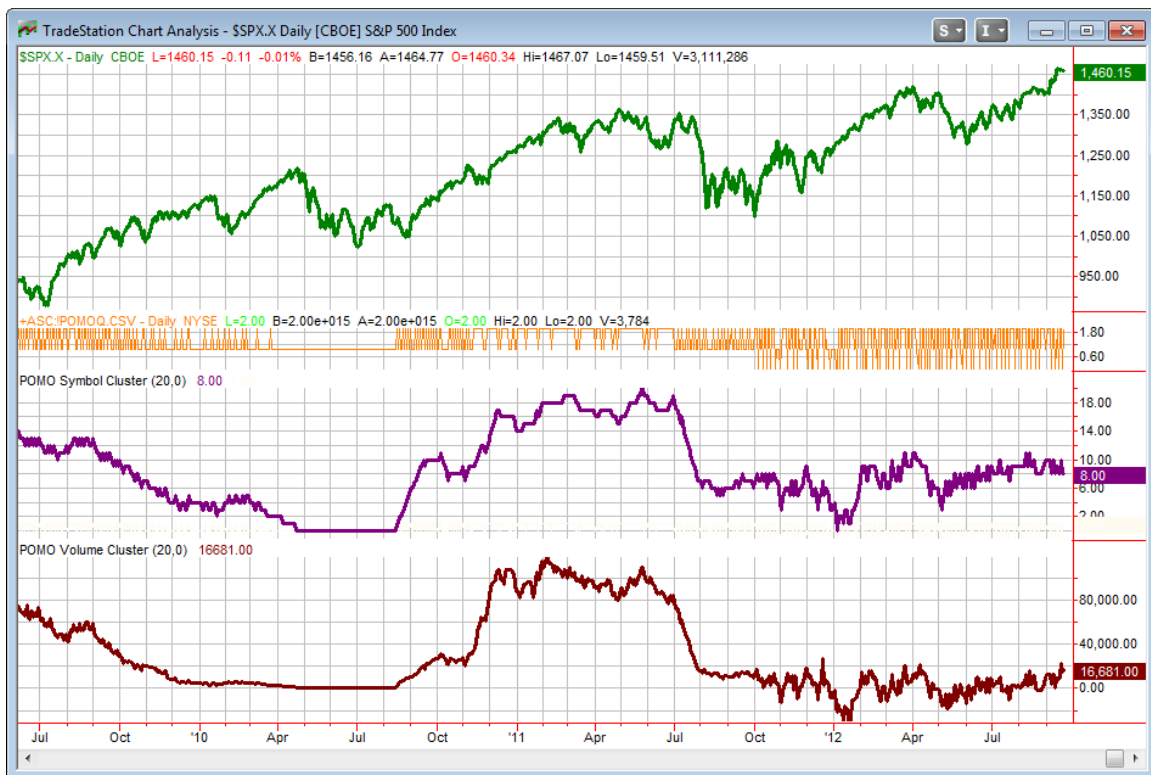
[http://www.newyorkfed.org/markets/ambs/ambs\\_schedule.html](http://www.newyorkfed.org/markets/ambs/ambs_schedule.html)

It is unclear whether they will show a daily schedule as they have done with POMO. Previous reinvestment schedules for AMBS transactions have only been posted weekly. This past week there was about \$10-\$11 billion additional purchased through QE3. Hopefully a daily schedule will be available. If not, I will guesstimate the amount as best I can. In any case, the QE Buying Power Index will now look at the combined numbers. Once the information availability is clearer after next week, I will likely hold an informational webinar to discuss adjustments I am making in the calculation due to QE3.

So for this week I adjusted the intermediate-term POMO chart to reflect estimated AMBS purchases as well. For those who may not recall below is a brief refresher on POMO. 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>



Total liquidity flows this week reach an estimated \$7 billion inflow. This caused the lower volume reading on the chart to begin to rise. We should see it continue to head up over the next few weeks.

With increased liquidity stimulus we would expect at least a short-term market boost. But the intermediate to long-term impact is less clear. Over the last several years the

market has required higher and higher amounts of stimulus to generate the same positive effect. This is because the all the stimulus has increased the monetary base. QE1 was a massive stimulus package, with inflows of between \$50-\$75 billion per month. QE2 saw monthly inflows of between \$80-\$115 billion per month. Assuming POMO flows remain around the net \$7 billion they have been, combined with the AMBS purchase there will be an inflow of about \$47 billion per month.

So QE3 will not be as powerful as QE1 or QE2. I'm not sure how a weaker stimulus into a larger monetary pool is going to succeed in turning around the economy when the last 2 attempts didn't get the job done. But the last 2 attempts DID get the market to rally. So I suspect QE3 has a decent shot of at least doing that for a while. And there really is no evidence suggesting I should bet against it from a market standpoint.

Therefore I will continue to favor long positions over short ones. In addition to the QE3 stimulus we have a strong uptrend, positive momentum, and Nasdaq leadership. The bond rate study from last week is really the only intermediate-term negative on my radar. My focus will continue to be in looking to buy pullbacks.

### **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**

*None*

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