

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 1, 2012

Volume 5 Issue 189

Market Overview



Signals Overview

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

Tonight's Research Points

- Turn of the month is often bullish, especially when short-term oversold during a long-term uptrend.
- The unfilled gap down following an unfilled gap up is potentially short-term bearish.
- The Nasdaq is no longer leading the S&P, meaning an end to one of our intermediate-term bullish signals.
- Lots more on POMO & QE3, including the new QE Buying Power Index calculation and chart.

Short-term Outlook

The Bottom Line

I still expect there is more bounce here and we should see a rise in the next few days. I am partially long and looking to take advantage of it.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
October 1, 2012	Last Day of Month < 10ma > 200ma	1-5 days	Bullish	2.20%
October 1, 2012	Unfilled gap up. Unfilled gap down.	1-3 days	Bearish	-1.60%
September 28, 2012	Unfill gap up from 10-low > 200	1-4 days	Bullish	1.90%
September 27, 2012	QE Buying Power Swing signal	1-3 days	Bullish	1.80%
September 26, 2012	4 down on Tuesday	1-6 days	Bullish	2.65%
September 26, 2012	4 down. Biggest today. > 200ma	1-3 days	Bullish	1.80%
September 25, 2012	3/10 HV < 0.25 4 days > 10ma > 200ma	1-4 days	Bullish	1.00%
Active - Long Term				
September 17, 2012	QE3	int term	Bullish	
September 17, 2012	SPX and TNX hit 50-day high	1-20 days	Bearish	
July 30, 2012	SPX 50-day high on 90% up vol	1-50 days	Bullish	
February 1, 2012	Golden Cross	int term	Bullish	
Dropped Tonight				
August 20, 2012	Nasdaq leading SPX	int term	Bullish	

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

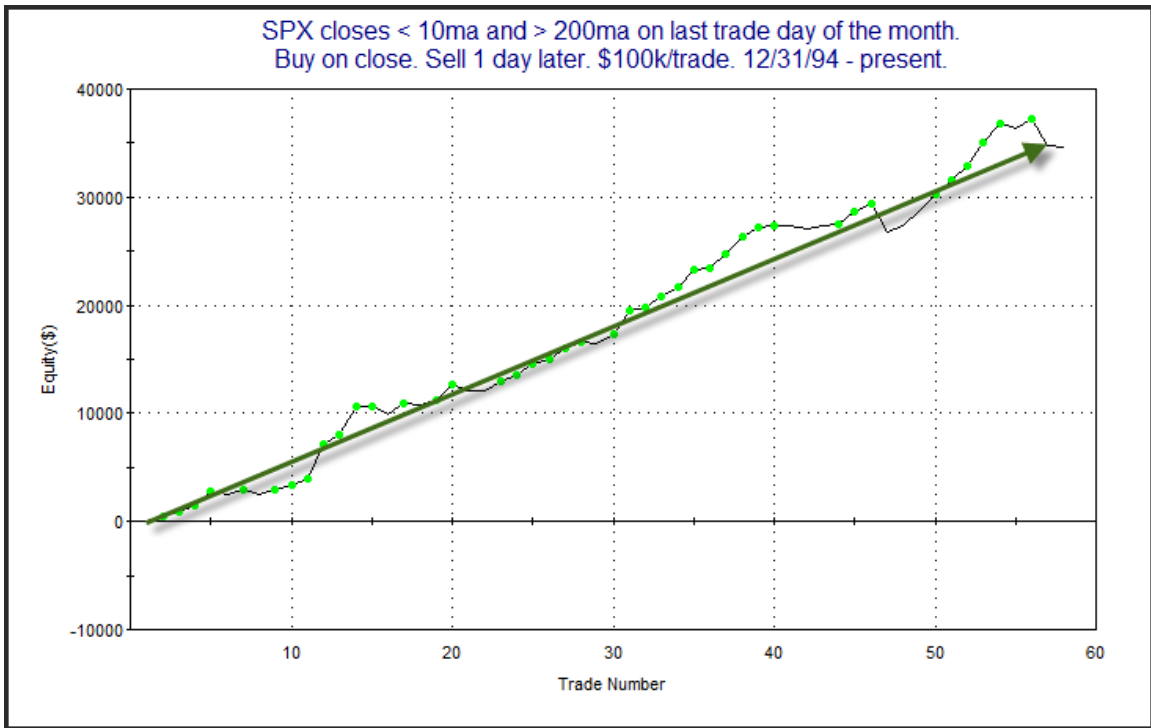
The Evidence

Friday gave back about half of what had been gained on Thursday. The SPX fell just under 0.5% and the NASDAQ and Russell 2000 each lost 0.7%. Breadth was squarely negative as the NYSE Up Issues % was 39% and the Up Volume % came in at 26%. Total NYSE volume rose to the highest level of the week.

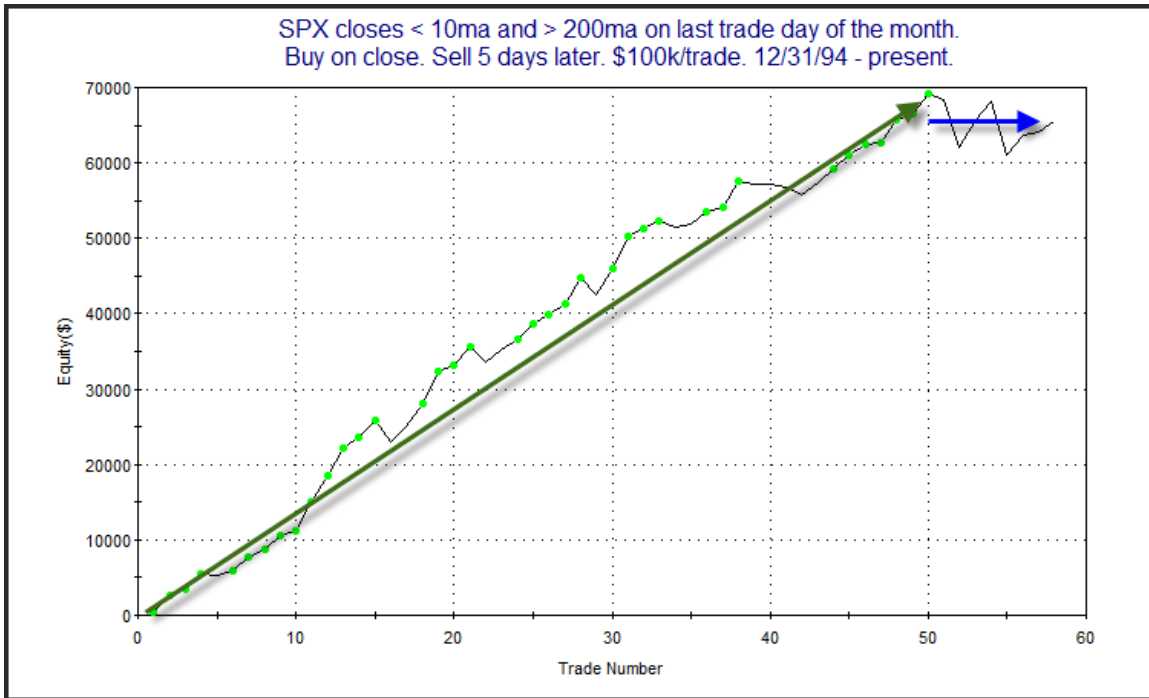
The Quantifinder noted some interesting tendencies that may be in force over the next few days. Beginnings of new months often arrive with seasonal strength. This has especially been true 1) during long-term uptrends, and 2) when the market is not already short-term overbought. The study below was last seen in the 9/4/12 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	65,619.40	58	47	11	81.03	1,909.26	4,435.97	-2,192.35	-7,153.30	0.87	3.72	1,131.37
4	57,787.41	58	46	12	79.31	1,708.24	3,838.00	-1,732.64	-7,100.17	0.99	3.78	996.33
3	42,730.61	58	40	18	68.97	1,694.76	3,709.44	-1,392.21	-3,492.36	1.22	2.71	736.73
2	33,725.24	58	42	16	72.41	1,291.52	3,442.32	-1,282.41	-4,320.06	1.01	2.64	581.47
1	34,642.96	58	44	14	75.86	975.56	3,119.10	-591.56	-2,559.62	1.65	5.18	597.29
53 of 58 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.



Despite a couple of recent losers, this is a very impressive and steady upslope. It certainly seems to confirm the upside edge. Now for the 5-day holding period.



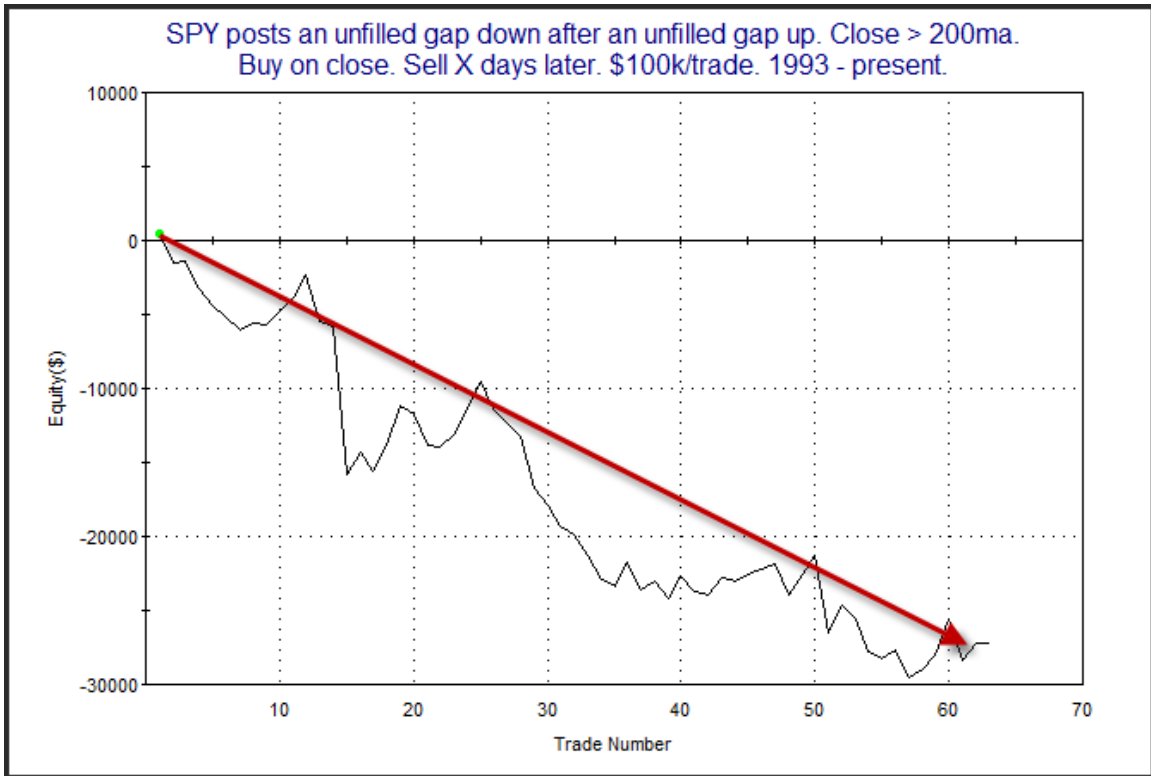
Three of the last seven instances here have struggled. That's not enough to abandon the study, especially after the edge was so steady for so long. Still, it bears watching and considering whether we should just view this as a 1-day edge in the future.

In the 7/11/11 Subscriber Letter I looked at other instances where the SPY posted an unfilled gap down after an unfilled gap up. I also incorporated a 200ma filter. Updated results for this study can be seen in the table below.

SPY posts an unfilled gap down after an unfilled gap up. Close > 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	-11,532.27	60	27	33	45.00	1,527.86	3,949.59	-1,599.53	-5,025.84	0.96	0.78	-192.20
4	-9,496.50	61	26	35	42.62	1,476.50	3,637.58	-1,368.16	-4,926.08	1.08	0.80	-155.68
3	-27,217.63	63	27	36	42.86	1,157.48	2,763.00	-1,624.15	-9,958.80	0.71	0.53	-432.03
2	-20,666.62	64	28	35	43.75	882.33	2,448.00	-1,296.34	-3,893.00	0.68	0.54	-322.92
1	-1,189.56	64	32	31	50.00	596.92	2,812.32	-654.55	-1,960.80	0.91	0.94	-18.59

Results here appear to suggest a short-term bearish edge. I also produced an equity curve.



While a few of the most recent instances have failed to decline, the downside inclination still appears to prevail.

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



With the mix of short-term studies tonight the green Aggregator Line dipped a little but still stayed squarely 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 above zero. This means the SPX is “oversold” versus recent expectations. So net expectations are bullish and the SPX is oversold. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. This caused the Aggregator system 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 strong bearish evidence emerges. The Differential Pivot will be mildly inverted at 1,439.61 on Monday. An inverted pivot means the Differential Line will cross 0 on a flat close. In this case the SPX will need to decline about 1 point if it is going to remain oversold. Otherwise, it will be considered overbought. So the Aggregator system will close out its long signal on a close above this inverted pivot.

I still like the long side. With an inverted Differential Pivot I won't look to immediately add more long exposure, but if we pull back further on Monday I may. I have two lots of SPY at the moment. Currently I plan to scale out in the following way. I will exit one lot

based on the Aggregator exit criteria – basically any close above the Differential Pivot in the next few days. The other lot I will likely hold onto until I get an exit signal via the QE Buying Power Swing System (most likely meaning a close in the top 50% of the 10-day range).

Intermediate-term Outlook (2 weeks – 2 months)– updated 10/1– bullish

I showed last week that the week after September options expiration has historically been the worst of the year, and it lived up to its billing by declining 4 of 5 days this past week. We are now presented with fewer bullish studies than we've had recently, but I still favor the long side.

The new POMO and QE3 AMBS schedules were posted on the Fed website, and I spent a good amount of time this weekend going through the information.

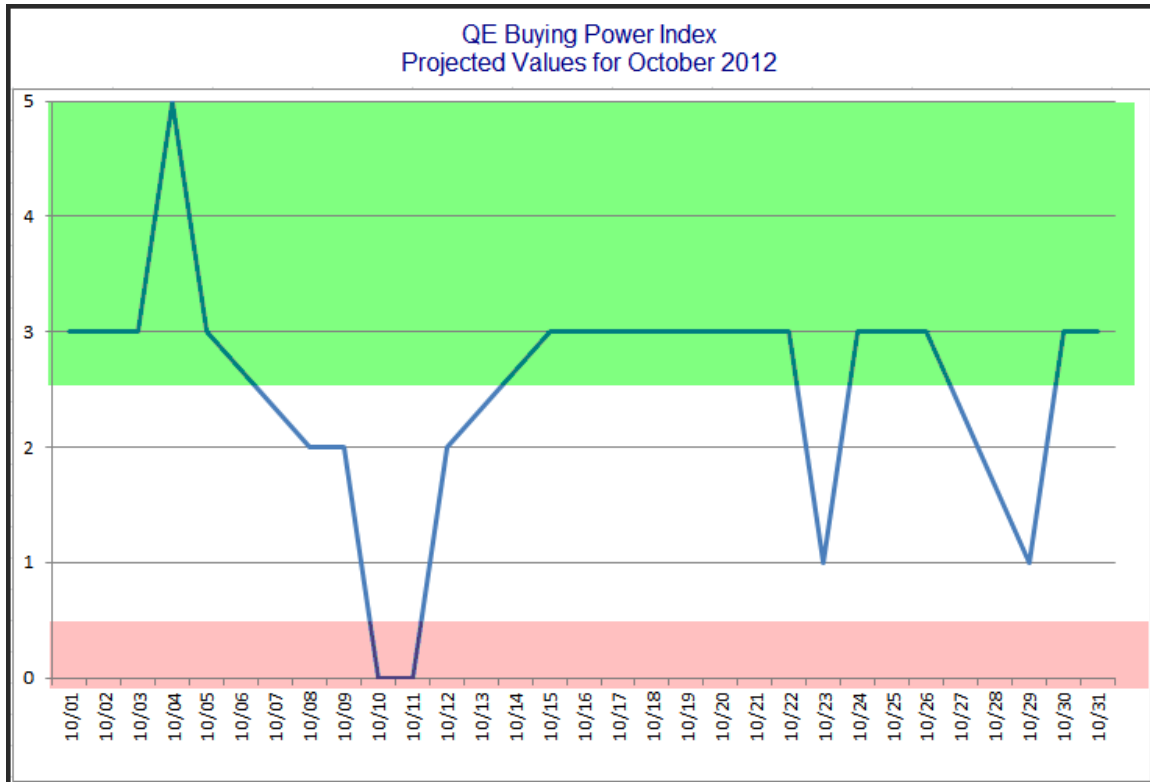
First I will discuss AMBS buying, which is the new factor in the QE Buying Power calculations. The schedule for October was released on Friday at the same time as the release of the October POMO schedule (2pm EST). A link to the schedule is below.

http://www.newyorkfed.org/markets/ambs/ambs_schedule.html

Unfortunately, as I feared the last couple of weeks, the Fed does not appear to be providing a daily schedule like they do for POMO. Rather, they are just indicating monthly amounts. This of course makes it a little more difficult to anticipate flows. But I looked at the AMBS buying results from Aug 14 – Sep 13, 2012 to see how consistent they were in their daily buying. This spreadsheet is available for download on the same page I just referenced above. While this is all pre-QE3 data, the report was encouraging in that they were very consistent with the buying. I added up the purchase amounts each day and they were almost all either \$1.3 billion or \$1.4 billion. (The last day of August was \$1.0 billion.) For those interested in seeing the spreadsheet with my totals you may download it using this link:

[2012-aug-sep fed flows.xls](#)

We know there are going to be 22 trading days in October (for the bond market, which is closed Columbus Day), and we know they intend to purchase \$40 billion worth of securities. This amounts to about \$1.818 billion per day. Therefore, in calculating the QE Buying Power Index, I have assumed this much per day on any day the bond market is open, and added it to the POMO schedule. The resulting values can be seen in the chart below:



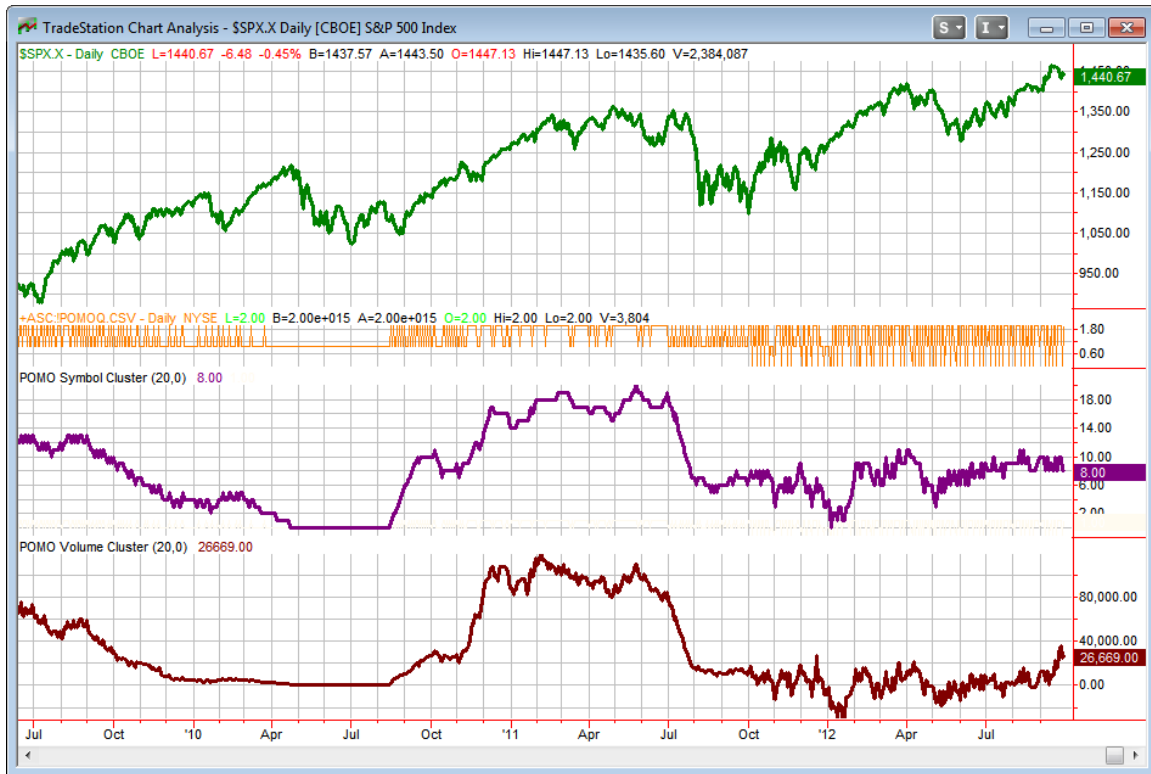
Thanks to QE3 most of the month will be liquidity positive. We will see a small dip in week 2 as the combination of a couple of negative POMO days and the Columbus Day off day move the index to 0. Other than that brief period I will be focused on long opportunities. For a detailed account of how this chart is constructed and other information and Fed links, subscribers may visit the QE Buying Power information page, which is linked to from the Systems page. I've also pasted a link below.

<http://www.quantifiableedges.com/members/qebuyingpower.php>

I also always update the intermediate-term POMO/QE3 chart each week. For those not familiar, below is a brief description.

POMO stands for Permanent Open Market Operations and it is how the Fed has gone into the open market to buy securities over the last several years. 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 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. Since the Sept 13, 2012 QE3 announcement the POMO numbers are also adjusted to reflected the Fed's new approach of buying AMBS securities. Therefore, prior to that date the indicators just look at POMO, since that date it is a combination of POMO and AMBS flows.



Total liquidity this week resulted in an estimated \$15.25 billion inflow. This caused the volume reading on the chart to continue to rise. We should see it continue to head up over the next few weeks.

This upcoming week is expected to see inflows Monday - Thursday, before selling causes an outflow on Friday. The net results should be about another \$15.3 billion inflow this upcoming week.

The recently increased liquidity will likely have a positive impact on the market. But as I discussed last week, QE3 flows are not as powerful as QE2 or even QE1. So the impact may not be as great either. While it will bear watching the assumption until proven otherwise is that QE3 and the increased liquidity it creates should serve as a boon to the stock market.

Therefore I will continue to favor long positions over short ones. In addition to the QE3 stimulus we have an existing uptrend and positive momentum. The bond rate study from 2 weeks ago 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

MS @ \$16.60 (buy 1/3 @ limit)

GS @ \$113.50 (buy 1/3 @ limit)

C @ \$32.51 (buy 1/3 @ limit) – *not filled*

BAC @ \$8.81 (buy 1/3 @ limit) – *not filled*

MS @ \$16.43 (buy 1/3 @ limit) – *not filled*

GS @ \$113.08 (buy 1/3 @ limit) – *not filled*

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 6/4(MS-2, GS-2, C, BAC)

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 1/4 index position @ \$143.28 LIMIT ON CLOSE. If close at a new 10-day low on Monday, I will buy it.

If SPY closes negative on Monday, I will look to buy any of the below Catapults at the close, using the following limit prices. I will NOT enter any of these on a positive SPY close.

C @ \$32.51 (buy 1/3 @ limit)

BAC @ \$8.81 (buy 1/3 @ limit)

MS @ \$16.43 (buy 1/3 @ limit)

GS @ \$113.08 (buy 1/3 @ limit)

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	9/25/2012	\$145.65	\$143.97	-1.15%		Aggregator
SPY(1/4)	9/26/2012	\$144.07	\$143.97	-0.07%		Aggregator
<i>INTC(1/3)</i>	<i>9/26/2012</i>	<i>\$22.53</i>	<i>\$23.06</i>	<i>2.35%</i>		<i>sold on open</i>
MS(1/3)	9/26/2012	\$16.60	\$16.74	0.84%		Catapult
GS(1/3)	9/26/2012	\$113.18	\$113.68	0.44%		Catapult

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