

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 29, 2012

Volume 5 Issue 209

Market Overview



Signals Overview

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

Tonight's Research Points

- Consolidations like we have seen the last 3 days after making new 20-day lows have shown a mild upside edge.

Short-term Outlook

The Bottom Line

After selling off fairly strong through Tuesday the market has consolidated now for 3 days. This gives me some concern about my long position. We could be seeing a pause before another leg down. I examined this idea down below and it appears the likely direction remains up. Still the overall risk/reward does not seem as strong as it was the last couple of days. I'll hold tight for now.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
October 25, 2012	20-low reversal	1-6 days	Bullish	
October 25, 2012	2x outside days	1-5 days	Bullish	
October 25, 2012	High vol from RSI(2)<5	1-3 days	Bearish	
October 25, 2012	Fed Day reversal down	1-3 days	Bullish	
October 24, 2012	SPY dn 1% and SOX up	1-6 days	Bullish	
October 24, 2012	4 lower lows. 20-day low.	1-8 days	Bullish	
October 22, 2012	QE Buying Power Swing long	1-7 days	Bullish	3.10%
October 22, 2012	Oversized drop on Friday	1-6 days	Bullish	2.75%
Active - Long Term				
October 25, 2012	20-low > 200ma on a Fed Day	1-9 days	Bullish	
October 24, 2012	SPY dn 1% and SOX up	1-20 days	Bullish	
October 19, 2012	SPY key reversal	1-12 days	Bullish	
October 15, 2012	Breadth not diverging at top	int term	Bullish	
September 17, 2012	QE3	int term	Bullish	
February 1, 2012	Golden Cross	int term	Bullish	

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

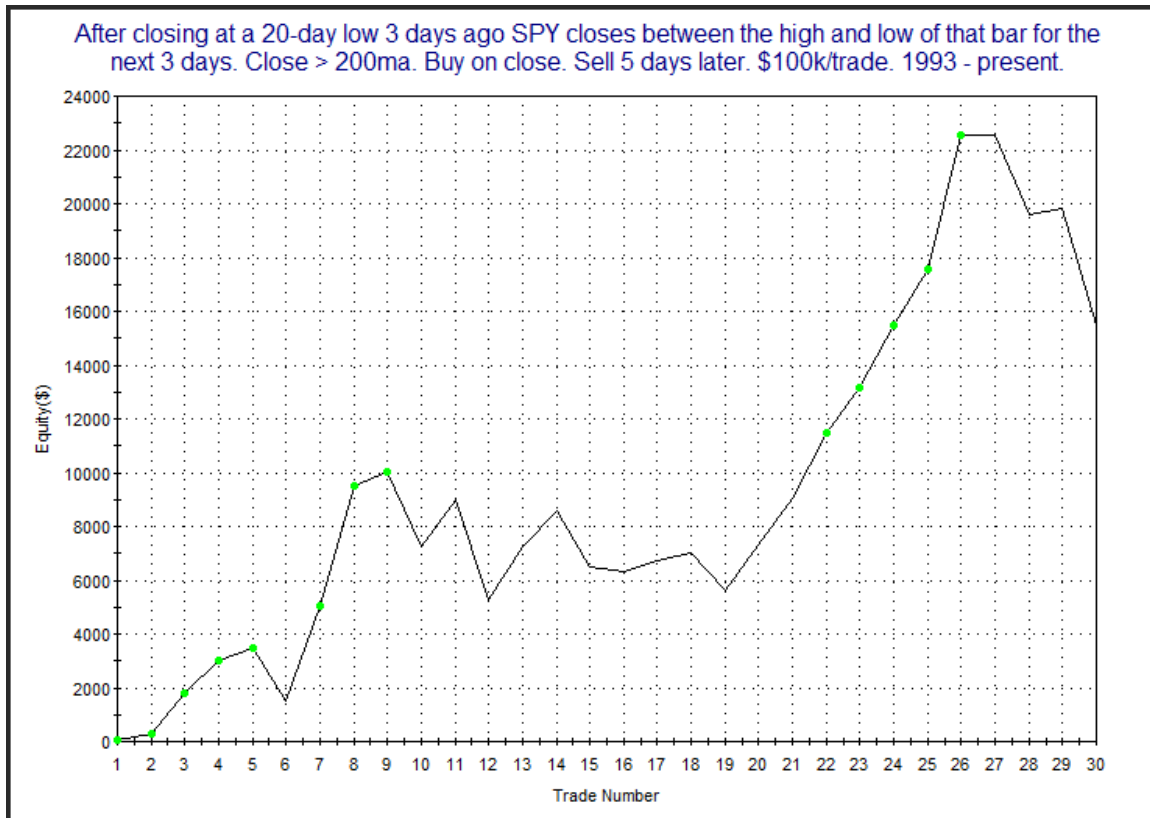
The Evidence

Despite an overnight scare and rebound, Friday was uneventful with little movement from the indices. The SPX, rose 0.1%, the Nasdaq lost 0.1% and the Russell 2000 rallied 0.4%. Breadth was negative as the NYSE Up Issues % was 41% and the Up Volume % came in at 30%. Total NYSE volume rose slightly from Thursday's level.

The mild back and forth the last 3 days did nothing to generate extremes or inspire new and compelling Quantifinder studies on Friday. After Tuesday's sharp selloff nothing further has been accomplished. The bounce, if you want to call it that, has been very weak. Neither bulls nor bears have been able to gain traction. So we have seen a tight consolidation. It is often said that consolidations resolve in the direction of the trend. Many would say that means down, since we are continually making 20-day lows. Others could claim that the trend is up, since SPX is still well above its 200ma. I decided to test it out and devised the below study.

After closing at a 20-day low 3 days ago SPY closes between the high and low of that bar for the next 3 days. 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	15,478.41	30	21	8	70.00	1,659.23	4,984.19	-2,420.68	-4,326.19	0.69	1.80	515.95
4	14,053.23	30	20	10	66.67	1,657.98	4,855.07	-1,910.64	-4,345.88	0.87	1.74	468.44
3	13,242.14	30	17	13	56.67	1,772.51	4,577.32	-1,299.28	-4,248.64	1.36	1.78	441.40
2	10,627.65	31	18	13	58.06	1,395.39	4,932.84	-1,114.57	-2,220.40	1.25	1.73	342.83
1	8,798.98	32	19	12	59.38	956.27	2,355.32	-780.84	-2,101.88	1.22	1.94	274.97

Closing between the high and low of the bar that put us at a 20-day low means 1) the selloff day was probably pretty large, and 2) the market has been moving sideways since. Results here, though not overwhelming, would seem to favor the bull case. I also examined the profit curves. The 5-day can be found below.



As you can see it has been very inconsistent. In fact, all of the curves appeared inconsistent. This study does not seem worthy of inclusion on the Active List. It does alleviate some concern that the sideways movement the last few days spells doom for a bounce.

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



The green Aggregator line remains 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 positive. 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 the close.

Based on the current studies, expectations are set to remain bullish again on Monday. Of course this could change should strong bearish evidence emerge. The Differential Pivot will be 1,415.52 on Monday. This is just 0.25% above Friday's close. So it won't take much to move the Differential Line into negative territory, signifying that SPX has moved from oversold to overbought.

Evidence continues to point higher. But the market is no longer as oversold as it was and it won't take much of a rally to move it off that oversold condition on Monday. I'm partially long. After some consideration I'll probably keep my exposure about where it is on Monday. I might lighten up at the end of the day on a rally. But if the market sells off strong I could consider upping exposure a little more on Tuesday. I will not get fully invested until we see a sizable spike in the CBI. And that only ticked up to 1 on Friday – so we've got a ways to go before the CBI is suggesting a bounce.

Intermediate-term Outlook (2 weeks – 2 months)– updated 10/29– bullish

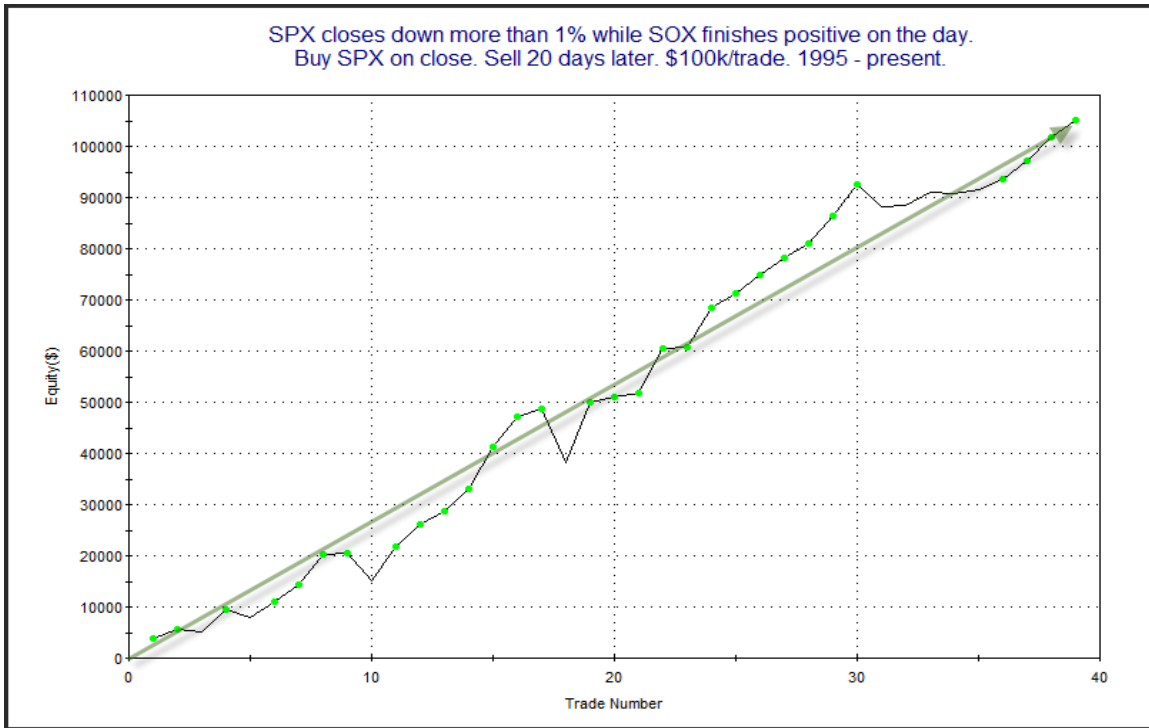
It was not a very good week for the market. The SPX lost 1.5% and despite being oversold and repeatedly at 20-day lows, could not muster a decent bounce. Interestingly, we had 2 studies with intermediate-term significance emerge this week. And both were bullish.

The first one looked at SPY vs. SOX action on Tuesday. I have copied my notes from the 10/24 letter below.

Comparative price action between SPY and SOX (semiconductor index) also appears to be suggesting a strong upside advantage. The SOX will often lead the market. In the 11/15/10 Letter I showed a study that indicated a positive close in the SOX on a day when the SPX drops more than 1% has often led to substantial gains over the next 1-4 weeks. I have updated that study below.

SPX closes down more than 1% while SOX finishes positive on the day. Buy SPX on close. Sell X days later. \$100k/trade. 1995 - 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
20	105,126.00	39	33	6	84.62	3,870.90	11,713.29	-3,768.95	-10,522.80	1.03	5.65	2,695.54
19	93,267.33	39	32	7	82.05	3,802.09	10,333.79	-4,057.09	-8,900.14	0.94	4.28	2,391.47
18	92,805.18	40	32	8	80.00	3,911.03	7,942.20	-4,043.49	-11,288.16	0.97	3.87	2,320.13
17	99,982.93	40	35	5	87.50	3,531.17	8,324.04	-4,721.62	-8,272.88	0.75	5.24	2,499.57
16	102,531.60	40	34	6	85.00	3,523.08	8,271.50	-2,875.51	-6,871.40	1.23	6.94	2,563.29
15	101,485.30	42	36	6	85.71	3,371.45	9,409.63	-3,314.51	-8,166.80	1.02	6.10	2,416.32
14	91,329.44	42	33	9	78.57	3,353.73	9,676.59	-2,149.30	-6,963.20	1.56	5.72	2,174.51
13	76,569.31	43	35	8	81.40	3,043.20	9,660.97	-3,742.83	-6,427.70	0.81	3.56	1,780.68
12	62,950.31	43	34	9	79.07	2,672.38	7,763.14	-3,101.20	-6,508.05	0.86	3.26	1,463.96
11	63,415.14	43	32	11	74.42	3,124.58	7,280.34	-3,324.68	-12,064.08	0.94	2.73	1,474.77
10	43,762.47	43	31	12	72.09	2,651.58	8,223.93	-3,203.04	-11,180.43	0.83	2.14	1,017.73
9	35,244.01	45	30	15	66.67	2,474.52	9,602.19	-2,599.44	-11,287.50	0.95	1.90	783.20
8	47,485.12	45	29	16	64.44	2,620.99	6,547.32	-1,782.72	-7,376.22	1.47	2.66	1,055.22
7	47,138.57	46	30	16	65.22	2,727.13	12,150.45	-2,167.21	-9,509.88	1.26	2.36	1,024.75
6	50,093.96	47	33	14	70.21	2,709.02	18,349.11	-2,807.40	-11,038.16	0.96	2.27	1,065.83
5	43,453.36	48	31	17	64.58	2,568.35	13,733.46	-2,127.38	-9,314.08	1.21	2.20	905.28
4	39,388.37	48	29	19	60.42	2,357.06	14,020.11	-1,524.55	-6,410.56	1.55	2.36	820.59
3	23,795.39	50	29	21	58.00	2,129.59	12,304.89	-1,807.74	-8,330.40	1.18	1.63	475.91
2	14,556.05	51	27	24	52.94	1,971.14	9,496.89	-1,611.03	-4,324.92	1.22	1.38	285.41
1	14,972.35	53	24	29	45.28	1,559.32	10,716.03	-774.19	-3,446.88	2.01	1.67	282.50

It's interesting here that there seem to be not only short-term bullish implications, but intermediate-term ones as well...



This equity curve is very strong and steady and shows no sign of weakness lately. I'd say this SOX/SPX study is well worth consideration for both the short and intermediate-term.

The next intermediate-term study was from the 10/25 letter. It looked at low closes on Fed Days. My notes from that letter are posted below.

I also thought today to examine 20-day lows that occur on Fed Days during long-term uptrends. The results appeared interesting. You'll find the stats table below.

SPX closes at a 20-day low on a Fed Day. Close > 200ma.
Buy on close. Sell X days later. \$100k/trade. 1982 - present.

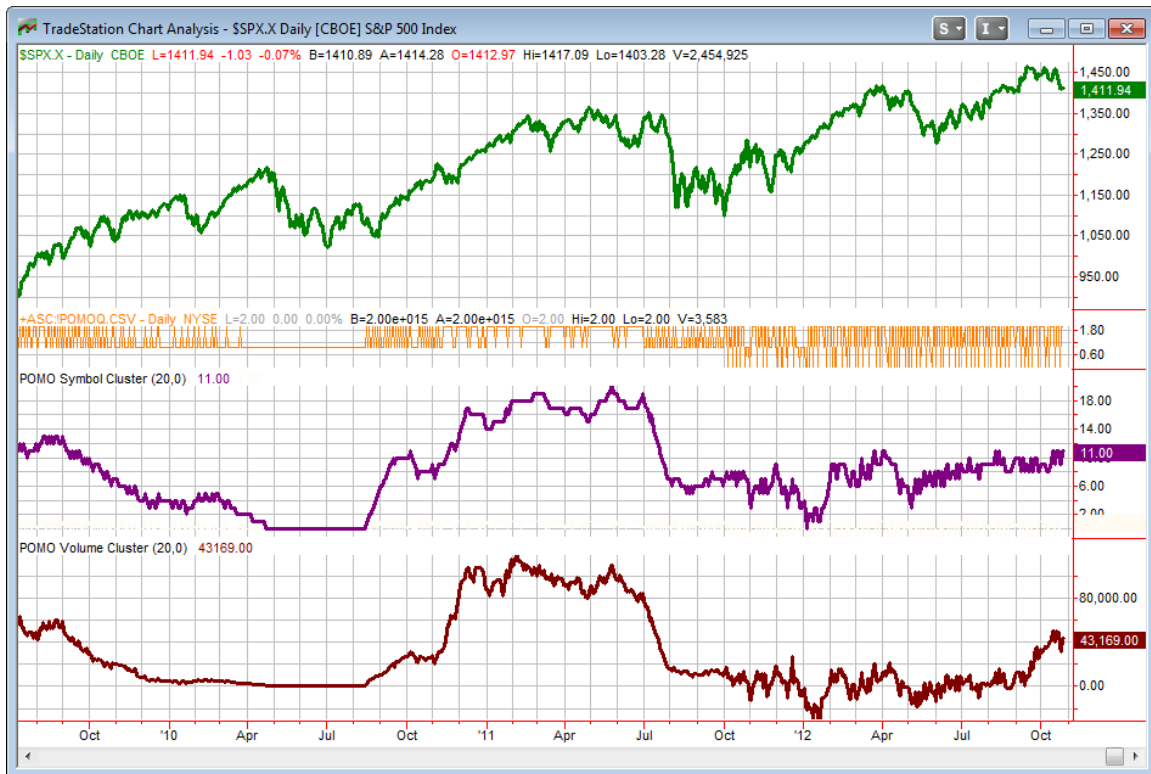
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: /Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	15,301.15	8	7	1	87.50	2,250.08	4,940.88	-449.44	-449.44	5.01	35.04	1,912.64
9	15,209.47	8	8	0	100.00	1,901.18	3,152.31	0.00	0.00	100.00	100.00	1,901.18
8	13,365.99	8	8	0	100.00	1,670.75	3,644.97	0.00	0.00	100.00	100.00	1,670.75
7	10,370.69	8	7	1	87.50	1,552.23	3,741.36	-494.91	-494.91	3.14	21.95	1,296.34
6	10,115.61	8	7	1	87.50	1,573.40	3,976.98	-898.17	-898.17	1.75	12.26	1,264.45
5	9,107.17	8	7	1	87.50	1,468.61	3,248.70	-1,173.12	-1,173.12	1.25	8.76	1,138.40
4	4,809.67	8	4	4	50.00	1,700.61	3,387.93	-498.20	-885.95	3.41	3.41	601.21
3	1,303.85	8	5	3	62.50	597.08	1,031.80	-560.52	-918.08	1.07	1.78	162.98
2	-120.14	8	4	4	50.00	415.58	1,056.00	-445.61	-712.72	0.93	0.93	-15.02
1	-2,446.69	8	4	4	50.00	381.61	717.20	-993.29	-1,949.22	0.38	0.38	-305.84

**There have only been 2 instances in the last decade:
3/22/05 and 3/15/11.**

Over the first 1-4 day period there doesn't appear to be much of an edge. But over the 5-10 day period the market has reliably risen. Instances are low, but I still thought the two-week results were strong enough to keep in mind. So I have added this study to the intermediate-term active list.

I 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.



The POMO/AMBS volume indicator is locked in its initial QE3 range now. While higher than Operation Twist, this is still below the levels of QE1 and QE2. Total liquidity flows this week resulted in QE3 - typical \$10 billion estimated inflow.

This upcoming week selling is scheduled for Monday and then Tuesday and Wednesday there will be buying. Wednesday we will see the November schedule for POMO released as well as an announcement of the November AMBS size.

Despite the fact that we are near 1-month lows, the bulls seem to have a decent amount of evidence on their side suggesting a run to a possible new high. As shown on the intermediate-term active list, bulls have an existing uptrend, strong liquidity, and price patterns as on their side. Breadth is also suggesting we should see higher highs ahead. The bears seem to have much less pointing in their favor. I continue to have more interest in long-side opportunities than in short-side opportunities.

Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

Open Catapult Triggers

New

LOW @ \$31.36 (buy 1/3 @ limit)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 1 (LOW)

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.

LOW – buy 1/3 Catapult position @ \$31.36 LIMIT. This is a Catapult trade idea.

Those unfamiliar with the catapult trades are encouraged to review the Catapult and CBI video, which can be found on the videos page. There is also a perma-link near the top of the catapult section above. Additional and more recent information can also be found in the "Catapult Exit Designer" presentation and tools, which are available for subscribers on the downloads page. Bottom line with the Catapults is that while they have performed quite well as a whole over time, they can be very volatile and I rarely trade them with stops, so position sizing is critical for managing risk.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	10/22/2012	\$143.15	\$141.35	-1.26%		Aggregator
SPY(1/4)	10/23/2012	\$141.42	\$141.35	-0.05%		sell @ \$141.75 limit on close

I'll look to close out 1 of the SPY lots if we get a decent move higher. The \$141.75 level should put SPX above the Differential Pivot.

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