

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 5, 2012

Volume 5 Issue 212

Market Overview



Signals Overview

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

Tonight's Research Points

- Down closes on Employment Days have often led to a rebound the next day.
- The November QE Buying Power Index shows liquidity inflows will be strongest at the beginning and end of the month.

Short-term Outlook

The Bottom Line

Bulls could not capitalize on Thursday's momentum or Friday's better than expected jobs report. While disappointing, that does not appear to set up a short-term bearish scenario. I am partially long and will look to increase my position size back to the levels it was at a couple of days ago. I believe we are likely to get a bounce this upcoming week. After that, things could get dicey.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
November 5, 2012	Down on Employment Day > 200	1 day	Bullish	
November 1, 2012	End of month < 10ma and > 200ma	1-5 days	Bullish	2.20%
October 25, 2012	20-low reversal	1-6 days	Bullish	
October 25, 2012	2x outside days	1-5 days	Bullish	
October 24, 2012	4 lower lows. 20-day low.	1-8 days	Bullish	
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 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	
Dropped Tonight				
October 19, 2012	SPY key reversal	1-12 days	Bullish	

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

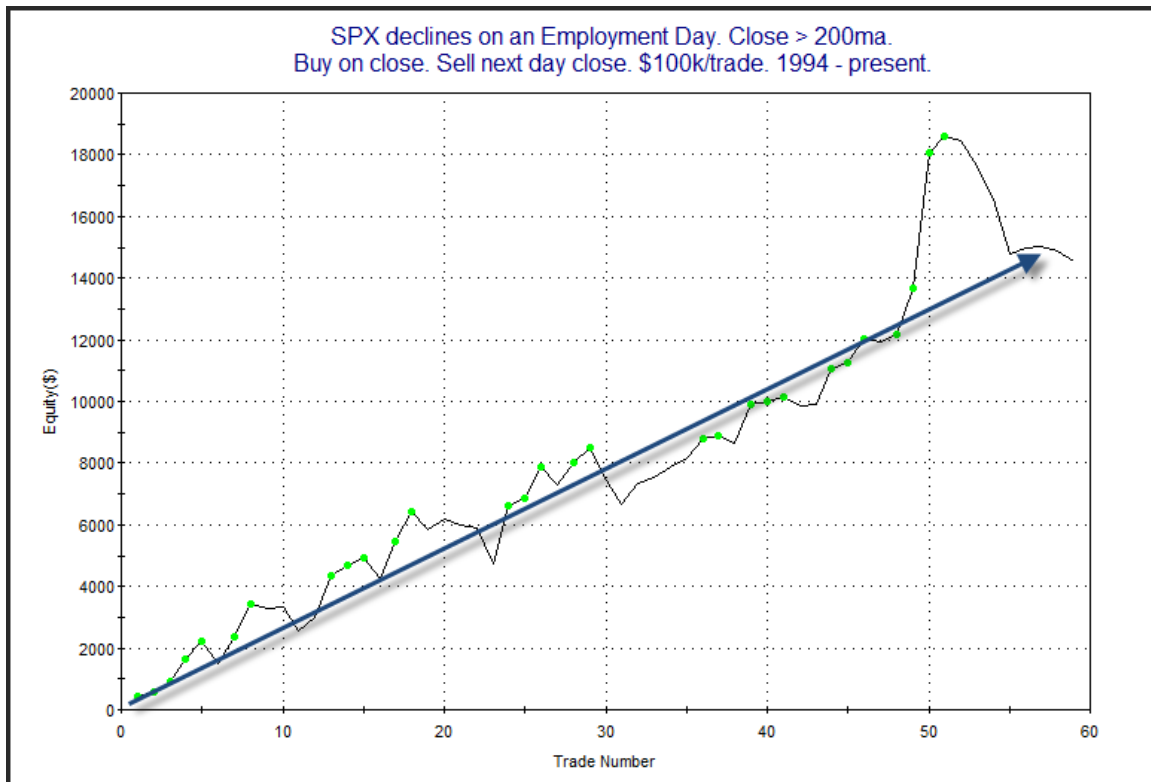
The Evidence

After a sizable rally Thursday the market reversed and gave back nearly all of what it had gained. The SPX lost 0.9%, the Nasdaq fell 1.3% and the Russell 2000 dropped an especially big 1.6%. Breadth was solidly negative as the NYSE Up Issues % was 29% and the Up Volume % came in at 24%. Total NYSE volume fell for the 2nd day in a row.

The study below was last seen in the 10/8/12 Letter. It looked at Employment Days where the SPX closed lower during long-term uptrends. Results are updated.

SPX declines on an Employment Day. Close > 200ma. Buy on close. Sell next day close. \$100k/trade. 1994 - present.				
TradeStation Performance Summary				Collapse ^
All Trades				
Total Net Profit	\$14,528.68	Profit Factor		2.24
Gross Profit	\$26,256.91	Gross Loss		(\$11,728.23)
Total Number of Trades	59	Percent Profitable		66.10%
Winning Trades	39	Losing Trades		20
Even Trades	0			
Avg. Trade Net Profit	\$246.25	Ratio Avg. Win:Avg. Loss		1.15
Avg. Winning Trade	\$673.25	Avg. Losing Trade		(\$586.41)

The stats here are solid and point to an upside edge. Below is a profit curve that shows how the possible edge has played out over time.



There were 4 instances in 2011 and they all closed lower. 2012 hasn't shown much favor either way so far. With a sample size this large the recent rough patch doesn't mean the edge has run its course, but recent action is a little discouraging. The profit curve is now just below its long-term trendline. So I'll be keeping a close eye on the next several instances but I'll still give this one some bullish credit.

I did look to slice and dice performance a few other ways based on the Employment Day action. Additional filtering did not give any great insights. For instance I looked at other times SPY gapped up, closed down, and closed over 1% below the open on Employment Days during uptrends. With these filters there were only 5 other instances and results were very mixed.

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 jumped back into positive territory with the big selloff. This means the SPX is oversold versus recent expectations. So net expectations are bullish and the SPX is back to 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 change from flat to long at the close.

Based on the current studies, expectations are set to remain bullish again on Monday. This is unlikely to change unless very bearish evidence emerges. The Differential Pivot will be 1,420.44 on Monday. This is 0.4% above Friday's close. So it would take a close higher of at least this much to move the Differential Line into negative territory, signifying that SPX has moved from oversold to overbought.

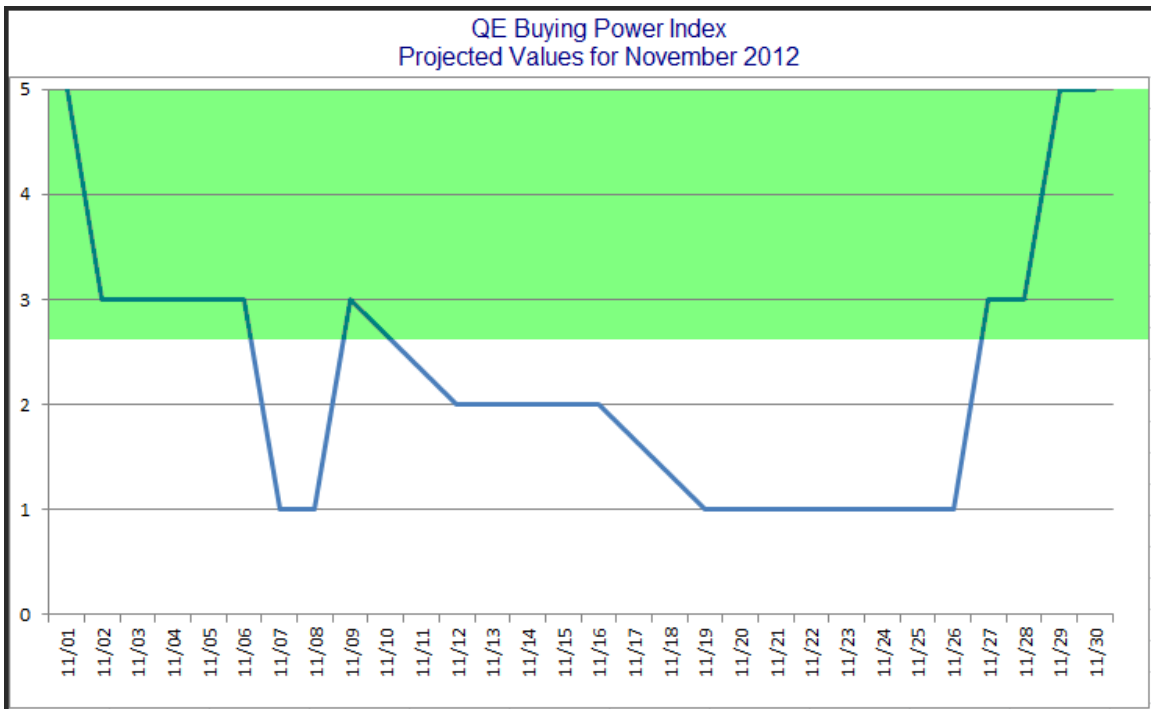
I thought we would get a little more out of the bounce. I was right for about 5 minutes. So I still have a small long position. In addition to tonight's little study, we have several studies still active from prior letters. And they all point up. Additionally, I'm just not seeing bearish evidence emerge. So I still like the long side. And I like it better here than I did on Thursday when I exited a portion of my long position. Therefore, if I can

get a favorable entry I will put that long position back on, which will put me at about 50% of the long index exposure that I'd be willing to take.

Intermediate-term Outlook (2 weeks – 2 months)– updated 11/5– bullish

It was certainly an unusual week for the market in that it only last 3 days thanks to Sandy. The 3-day total saw a slight rise with Thursday's big up day and Friday's big down day as the highlights. There were no new studies that emerged with intermediate-term implications, but the Fed did announce its POMO and AMBS intentions for November.

I've calculated the November QE Buying Power Index, which shows the expected ebbs and flows of the liquidity infusion. This chart may also be found on the [QE Buying Power Index page](#).



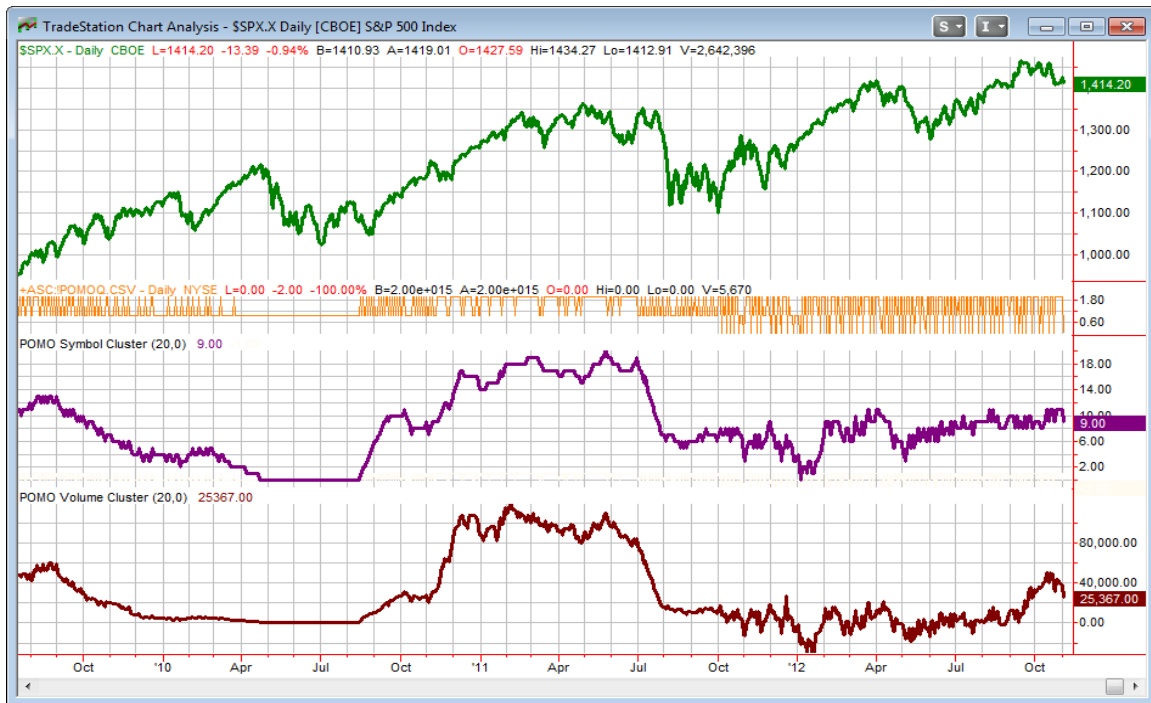
November is expected to be front and back-loaded. The QE Buying Power Index should remain at 3 through Tuesday, and then after a brief 2-day drop to 1 on Wednesday and Thursday, will return to 3 on Friday. But after that, even with AMBS flows factored in, the QE Buying Power Index is expected to remain in neutral territory until Tuesday the 27th. It will then close out the month with a strong run of liquidity infusion.

This suggests that if bears are going to push their agenda, the most opportune time to do it would be from the 7th through the 26th of the month. (And the 7th may be a bit early since we do have 1 more bullish reading on the 9th.)

As they did in October, the Fed has scheduled an additional \$40 in AMBS buying for November. AMBS purchases have been steady in recent months, unlike POMO buying & selling, which is done according to their somewhat unusual schedule. So in calculating the QE Buying Power Index I assumed \$2 billion in QE3 AMBS purchases each day. (The bond market will be open for 20 trading days in November.)

I 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 dipped a little this week and is at the low end of its expected QE3 range. While higher than Operation Twist, it should remain below the levels of QE1 and QE2. With the markets closed some this week we estimate there was a net outflow of about \$1 billion.

Buying is expected to be strong this upcoming week and we should see an inflow of about \$17 billion in liquidity. Infusions in the following weeks won't be as strong until we reach the end of the month.

Liquidity inflows should continue to help the stock market while QE3 is in effect. The concern I have is that the size of QE3 is lower than previous pumpings. The market has already been propped up over the last few years thanks to QE1, QE2, and to a lesser extent Operation Twist. To continue to get the some market moving impact it would typically take higher levels of stimulus, not lower ones. The market is better off with some stimulus than none, but unless levels increase in coming months, QE3 could leave the market susceptible to a sizable correction.

To this point I am not yet seeing strong evidence that a substantial correction has begun. Despite the fact that we are near 1-month lows, the bulls seem to have a decent amount of evidence on their side. As shown on the intermediate-term active list, bulls have an existing uptrend, strong liquidity, and price patterns on their side. Breadth is also suggesting we should see higher highs ahead. Evidence can swing at any time, but I continue to favor the long side.

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

New

ALL – 1/3 @ \$38.56 (buy @ limit)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 1(ALL)

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 ¼ index position @ \$141.56 LIMIT ON OPEN. If not filled on open, cancel order and look to buy at \$141.56 LIMIT ON CLOSE.** I am looking for a favorable entry for a 2nd lot here.*

***ALL – buy 1/3 Catapult position @ \$38.56 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	\$141.56	-1.11%		Aggregator

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