

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 3, 2012

Volume 5 Issue 231

Market Overview



Signals Overview

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

Tonight's Research Points

- When the last trade day of the month is a Friday, then Monday has done very well during uptrends. Less so when the SPX is already short-term overbought.
- VIX up and SPX up on a Friday has typically been followed by a pullback over the next few days.
- POMO and AMBS liquidity flows are examined for December.

Short-term Outlook

The Bottom Line

Similar to Thursday night, there appears to be a very mild and very short-term bearish edge. It isn't strong enough to get me interested in a trade. I'm waiting for a better setup.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
December 3, 2012	VIX up SPX up Friday	1-3 days	Bearish	
December 3, 2012	1 day dn after 5 up	1 day	Bullish	
November 29, 2012	8-day closing range > 75	1-3 days	Bearish	
November 27, 2012	1 day dn after 5 up	1-9 days	Bullish	2.10%
Active - Long Term				
December 3, 2012	Nasdaq leading SPX	int term	Bullish	
November 26, 2012	90% up vol studies.	1-15 days	Bullish	
November 19, 2012	CBI >= 11	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	

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

The Evidence

After spending most of the day in negative territory, a late surge left the indices mixed and near breakeven. The SPX rose 0.02%, the Nasdaq fell 0.06%, and the Russell 2000 declined 0.16%. Breadth was slightly positive as the NYSE Up Issues % was 55% and the Up Volume % came in at 54%. Total NYSE volume surged to the highest level in a couple of weeks.

The price surge in the last few minutes of trading that caused the SPX to finish positive also turned around some of the Quantifinder studies. As you'll see, they were mixed with a slight downside bias.

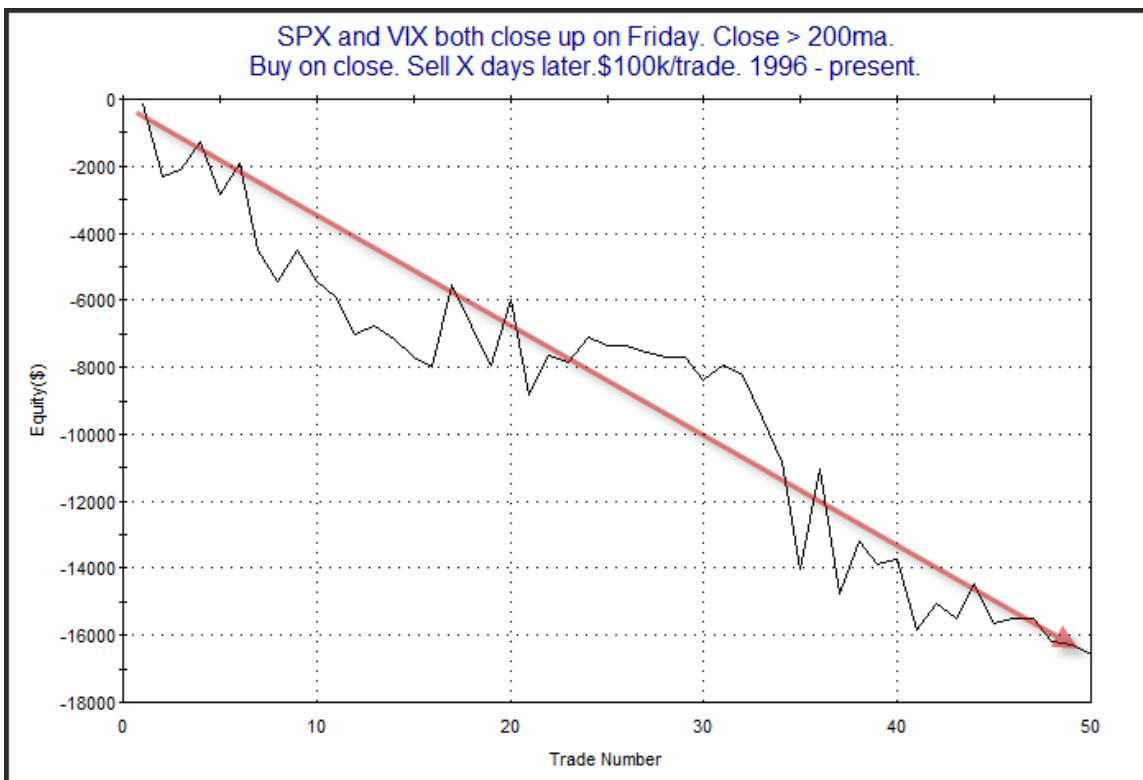
Even with the SPX rising, the VIX managed to close up a bit. The VIX will typically trade in a direction opposite the SPX, so it is unusual that they both close higher. On Fridays, the VIX has a natural tendency to dip in the afternoon, so it is *most* unusual to see them both close higher on Friday. The study below was last seen in 9/17/12 subscriber letter. It examines other instances of the VIX and SPX both closing higher on a Friday while the SPX is in an uptrending market. All stats are updated.

SPX and VIX both close up on Friday. Close > 200ma.
Buy on close. Sell X days later. \$100k/trade. 1996 - present.

X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Max Winning Trade	All: Avg Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: Profit Factor	All: Avg Trade
5	-15,237.72	49	19	30	38.78	4,290.80	1,464.44	-1,435.40	-3,118.36	1.02	0.65	-310.97
4	-17,146.83	50	20	30	40.00	4,275.84	1,088.02	-1,296.90	-4,306.02	0.84	0.56	-342.94
3	-16,581.76	50	17	33	34.00	3,000.26	973.19	-1,003.82	-3,727.50	0.97	0.50	-331.64
2	-12,671.50	50	21	29	42.00	2,380.51	754.66	-983.42	-3,595.20	0.77	0.56	-253.43
1	-10,378.73	50	16	34	32.00	1,530.15	501.77	-541.38	-2,361.45	0.93	0.44	-207.57

47 of 50 instances (94%) closed below the entry price at some point in the next week.

As you can see, there appears to be a decent downside edge suggested by this study. That edge primarily plays out over the first three days. Below is an equity curve showing how the edge has evolved assuming that 3-day holding period.



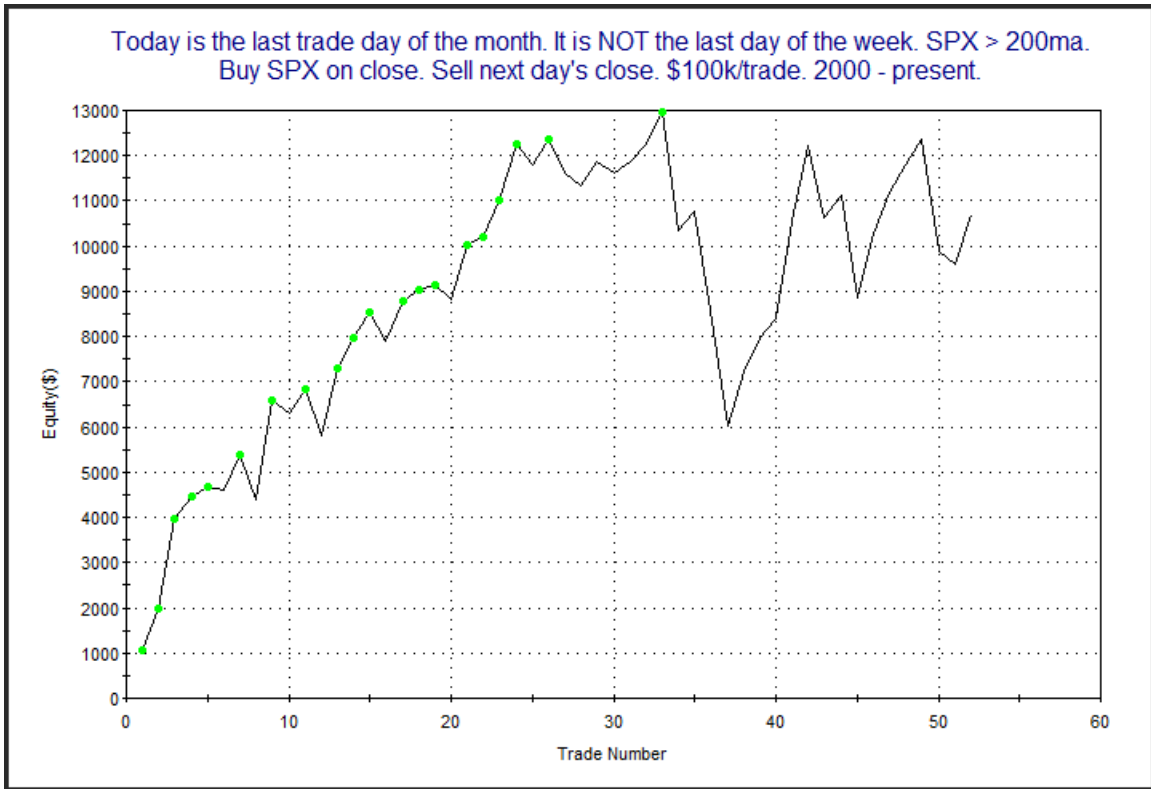
Considering the fact that the study utilizes a long-term uptrend filter, the persistent downslope is quite impressive. The last instance once again put the equity curve at new lows.

Since the late 80s / early 90s there has been a bullish bias on the first trading day of the month. Over the years I've detailed a few variables that have impacted this tendency. One of the more prevalent is whether the market is in an uptrend or not. The edge has typically been strong during uptrends, but nonexistent during downtrends. In Thursday night's letter I compared instances when the last trading day of the month arrived on a Friday (or Thursday if Friday was a holiday) versus times the turn of the month happened during the week. The results were very interesting. First, here are the stats when turn of the month has happened mid-week.

Today is the last trade day of the month. It is NOT the last day of the week. SPX > 200ma.
Buy SPX on close. Sell next day's close. \$100k/trade. 2000 - present.

TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	\$10,690.97	Profit Factor	1.56
Gross Profit	\$29,752.06	Gross Loss	(\$19,061.09)
Total Number of Trades	52	Percent Profitable	67.31%
Winning Trades	35	Losing Trades	17
Even Trades	0		
Avg. Trade Net Profit	\$205.60	Ratio Avg. Win:Avg. Loss	0.76
Avg. Winning Trade	\$850.06	Avg. Losing Trade	(\$1,121.24)
Largest Winning Trade	\$2,225.00	Largest Losing Trade	(\$2,617.60)

Results here appear mildly bullish. Here is a profit curve to see how it's played out over time.

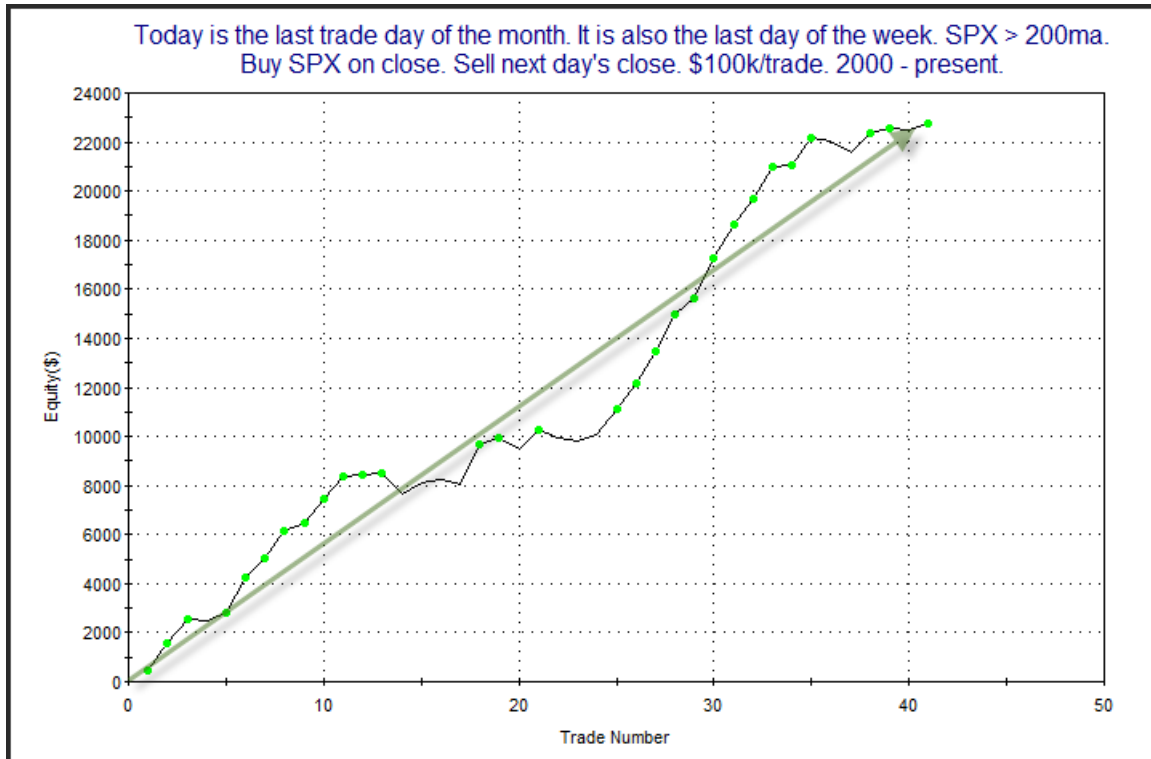


It appears that in recent years the upside tendency has largely failed to play out when turn of the month has occurred in the middle of the week. But what of times the month turns on a weekend?

Today is the last trade day of the month. It is also the last day of the week. SPX > 200ma.
Buy SPX on close. Sell next day's close. \$100k/trade. 2000 - present.

TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	\$22,731.90	Profit Factor	9.67
Gross Profit	\$25,353.45	Gross Loss	(\$2,621.55)
Total Number of Trades	41	Percent Profitable	78.05%
Winning Trades	32	Losing Trades	9
Even Trades	0		
Avg. Trade Net Profit	\$554.44	Ratio Avg. Win:Avg. Loss	2.72
Avg. Winning Trade	\$792.30	Avg. Losing Trade	(\$291.28)
Largest Winning Trade	\$1,638.40	Largest Losing Trade	(\$807.70)

These numbers are much, much stronger. And below is the profit curve.



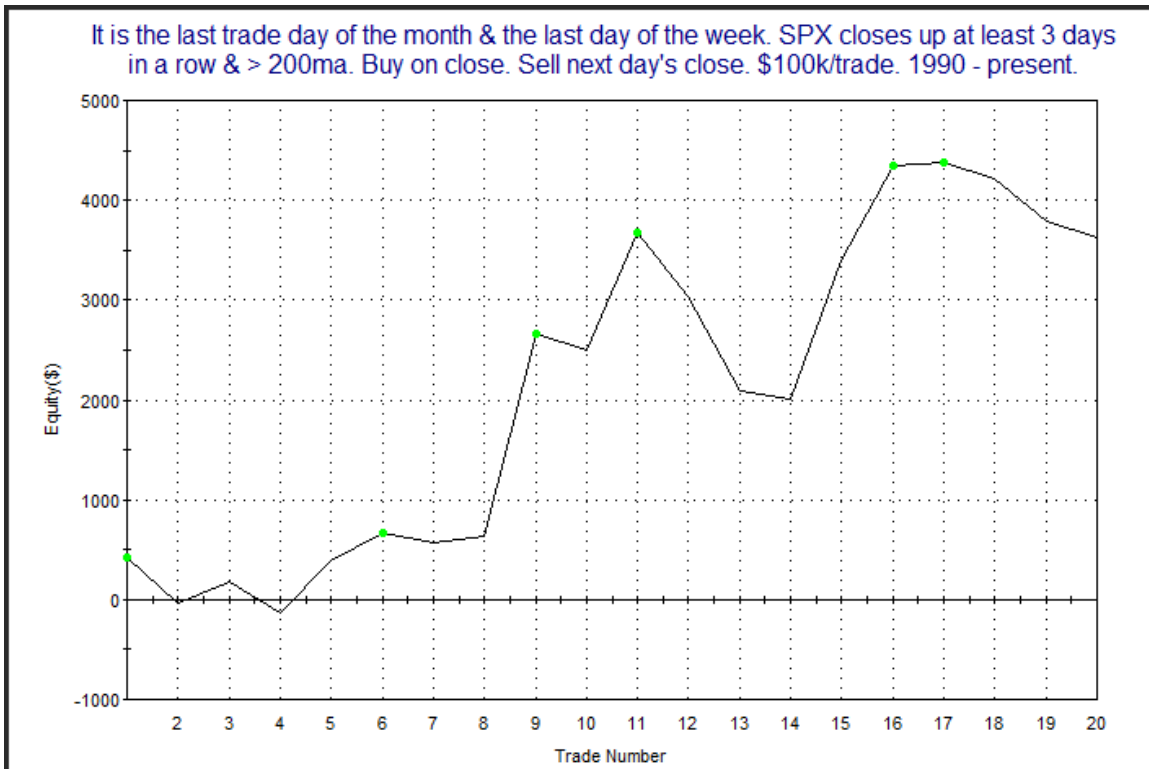
This is a very impressive looking curve to go with the very impressive numbers. And it would seem to suggest a decent upside edge for Monday.

There is one issue though. SPX is short-term overbought. Some studies in the Quantifinder looked at other times where the market finished up several days in a row to finish the month. The finding was basically that this tended to eliminate much of the upside edge. So I combined those studies with the one above to see how that played out. Note that for this study, in order to get enough instances, I looked back to 1990, rather than 2000 as I have done above.

It is the last trade day of the month & the last day of the week. SPX closes up at least 3 days in a row & > 200ma. Buy on close. Sell next day's close. \$100k/trade. 1990 - present.

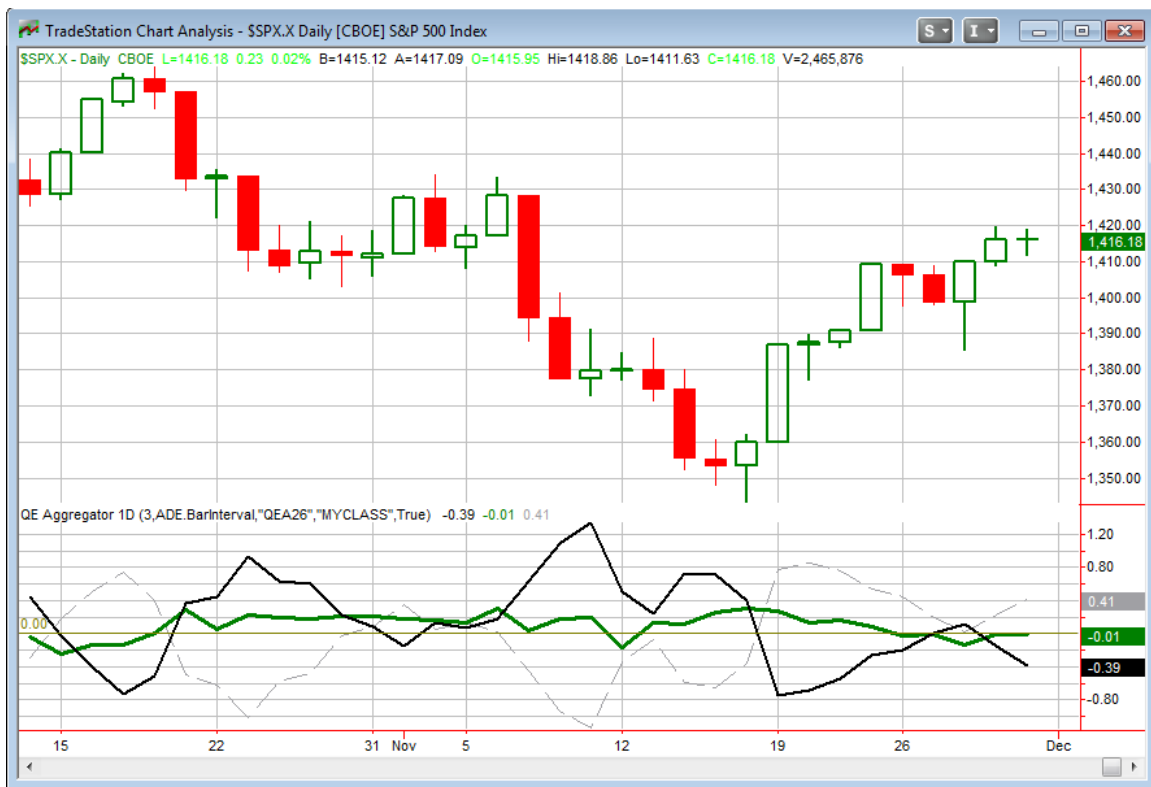
TradeStation Performance Summary				Collapse ^
All Trades				
Total Net Profit	\$3,622.99	Profit Factor		2.06
Gross Profit	\$7,052.49	Gross Loss		(\$3,429.50)
Total Number of Trades	20	Percent Profitable		50.00%
Winning Trades	10	Losing Trades		10
Even Trades	0			
Avg. Trade Net Profit	\$181.15	Ratio Avg. Win:Avg. Loss		2.06
Avg. Winning Trade	\$705.25	Avg. Losing Trade		(\$342.95)
Largest Winning Trade	\$2,015.52	Largest Losing Trade		(\$954.04)

Chances of a move higher seem to be reduced to breakeven, but winners have been twice the size of losers so there still appears to be a mild upside edge. Here's the profit curve for those that are curious.



It appears choppy, and certainly not as attractive as the study without the streak of three up closes, but I've decided it's good enough to take under consideration.

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



The green Aggregator line again finished just barely below zero. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line is also negative. 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. This caused the Aggregator system to remain short at the close on a weak signal.

Based on the current studies, expectations are set to turn positive on day. Of course this could change if bearish studies emerge. The Differential Pivot will be 1,407.58 on Monday. This is about 0.6% below Friday's close. So it would take a decline of at least this much for the SPX to close in oversold territory.

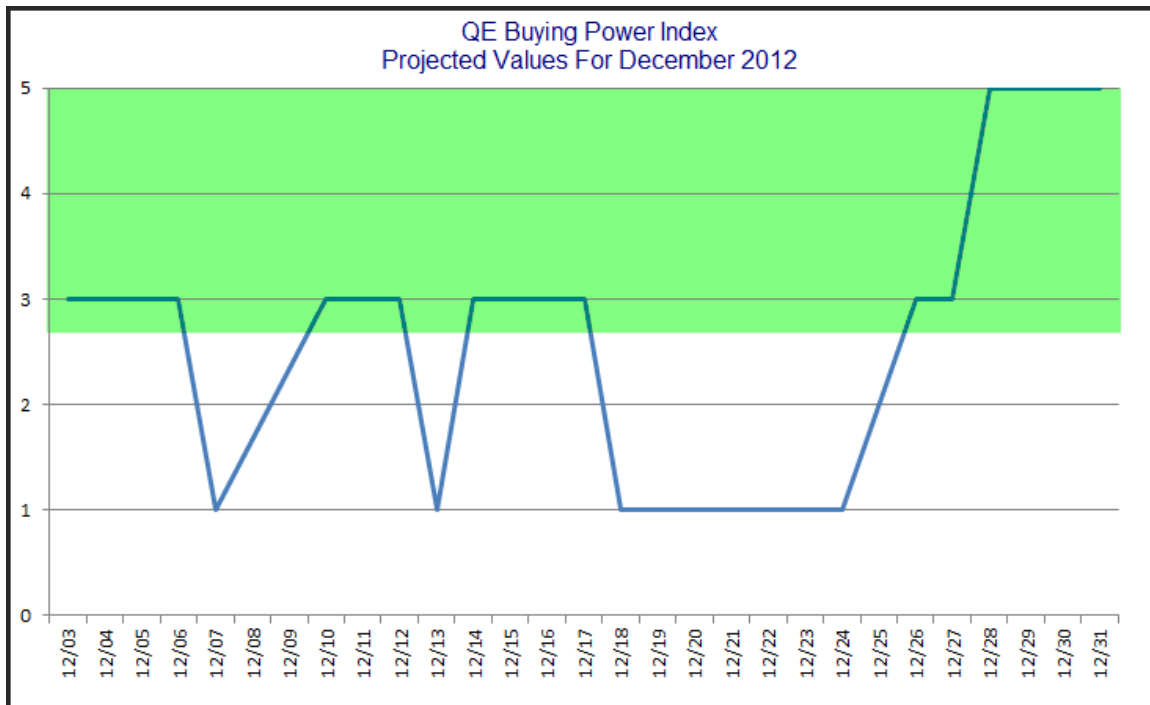
Similar to Thursday, we have a short signal, but it is fairly weak. Expectations are just below breakeven and are set to turn positive on Monday. Additionally, the QE Buying Power Index is at a max 5. Plus the intermediate-term outlook is bullish. That's too much for me to consider taking a weak short. I'll continue to wait for a more favorable entry opportunity.

Intermediate-term Outlook (2 weeks – 2 months)– updated 12/3– bullish

The SPX saw a mild gain of about 0.5% this past week. It is now squarely above its rising 200ma, and just barely below its declining 50ma.

One bit of bullish news this week is that the NASDAQ was able to regain its leadership position after lagging since late September. This is based on the SPX/NASDAQ Relative Strength Indicator that can be found on the charts page. Since the inception of the Nasdaq, the SPX has gained over 1,450 points when then Nasdaq was in leading position and has lost ground when the SPX is leading. The indicator long signals have not made a lot of progress in the last 5 years, but I would still prefer to see a leading Nasdaq. More information on the indicator may be found [in this old blog post](#). Any subscriber who wants to download the model may do so on [the Downloads page](#). The data in the Excel version has not been updated in a while, but the calculations are all there.

In other news the Fed announced its POMO and AMBS schedules for December. I've calculated the December 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](#).



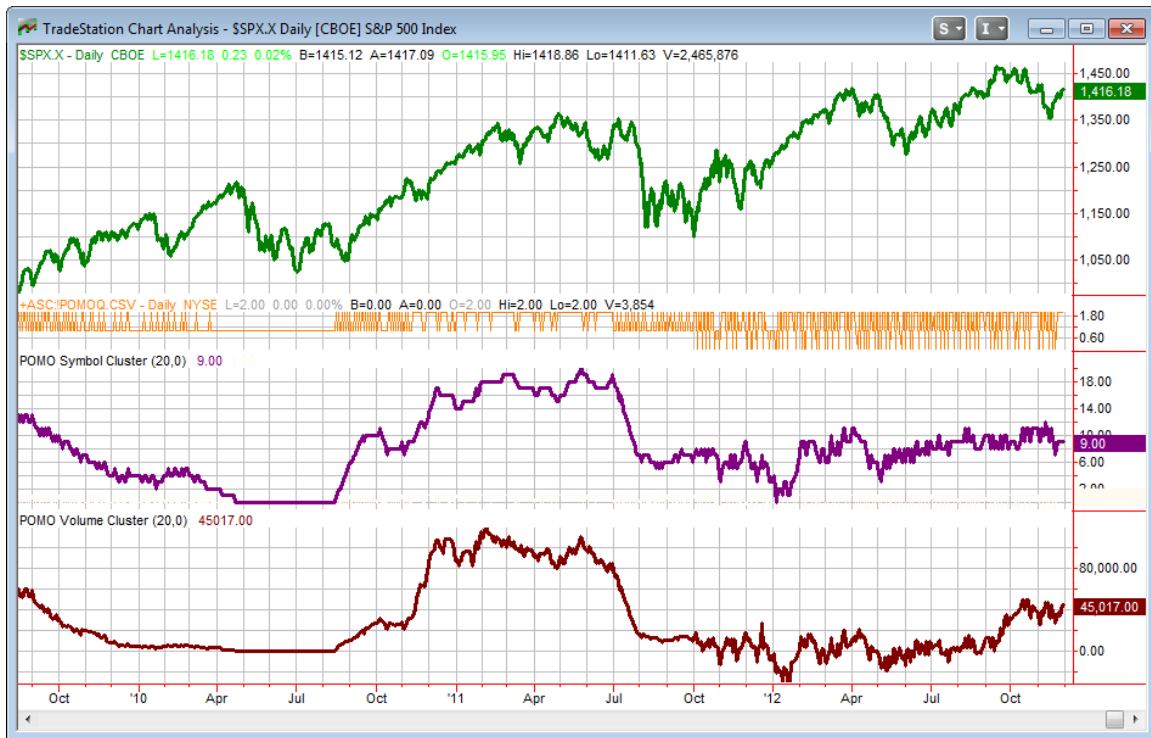
Flows are expected to do be generally strong, except for the week leading up to Christmas. During that period the QE Buying Power Index is expected to remain in neutral territory. It will then close out the month with a strong run.

This suggests that if bears are going to push their agenda, the most opportune time to do it would be from the about the 18th through the 27th of the month

As they did in October and November, the Fed has scheduled an additional \$40 billion in AMBS buying for December. 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.

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 is now in the upper end of its expected QE3 range, but still showing sizable inflows. While higher than Operation Twist, levels should remain below those of QE1 and QE2. We estimate there was a huge net inflow of about \$26.7 billion this past week.

This upcoming week we are expecting to see net selling on Monday and Friday and net buying on Tuesday, Wednesday, and Thursday. This is all expected to result in a net inflow of about \$8 billion. The QE Buying Power Index will dip to 3 on Monday and remain there through Thursday. On Friday it is expected to drop to 1, before bouncing back up the following day.

While SPX is now overdone short-term, there is decent evidence that higher prices appear likely over the next several weeks. Breadth has provided a number of bullish clues. Liquidity is also anticipated to remain strong. And the NASDAQ is now leading. 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

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.

Current Open Trade Ideas

None

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