

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 10, 2012

Volume 5 Issue 236

## Market Overview



## Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Flat	50% Long XIV	Flat	Flat

## Tonight's Research Points

- The light volume Friday does not appear to be the bad omen it once was.
- The tight range over the last few days suggests we could see a sharp move in the next few.
- Liquidity is expected to remain strong this upcoming week.

## *Short-term Outlook*

### *The Bottom Line*

Friday's mixed action failed to generate meaningful studies. The market remains mildly overbought and expectations remain moderately bullish. I don't see a strong directional edge, so I'll wait for one to emerge before re-entering the market.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
December 5, 2012	1st 5 day low in 10 days	1-4 days	Bullish	1.60%
December 4, 2012	3-high outside day dn	1-5 days	Bullish	2.20%
<b>Active - Long Term</b>				
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	
<b>Dropped Tonight</b>				
November 27, 2012	1 day dn after 5 up	1-9 days	Bullish	2.10%
December 3, 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.

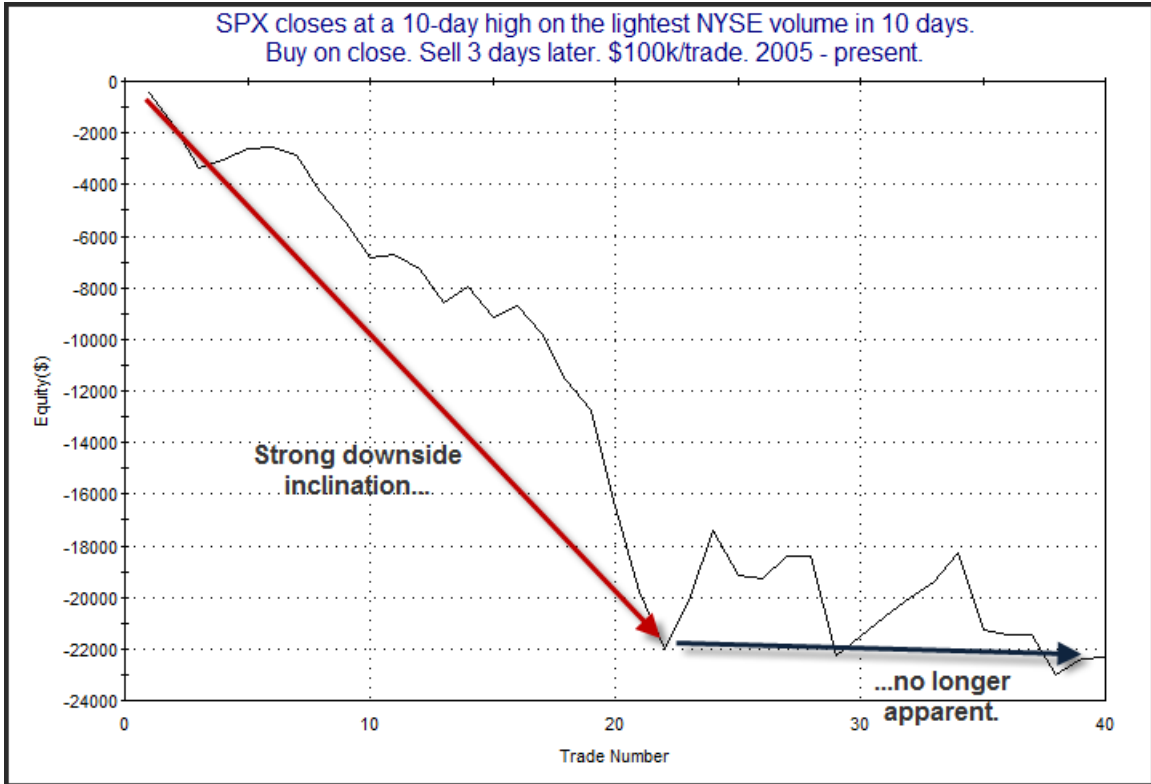
**The Evidence**

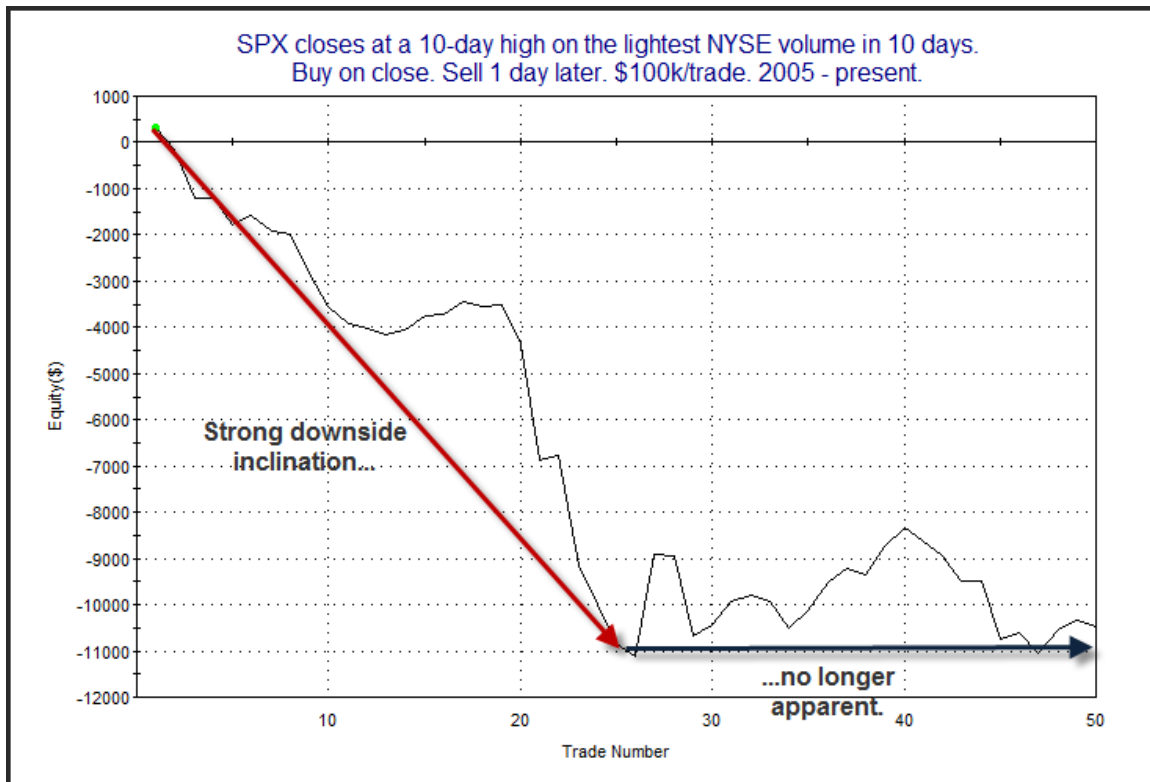
After a positive reaction to the jobs report Friday saw mixed results from the indices. The SPX gained 0.3%, while the NASDAQ lost 0.4%, and the Russell 2000 inched up 0.1%. Breadth was positive as the NYSE Up Issues % was 54% and the Up Volume % came in at 70%. Total NYSE volume came in at the lightest level since just after Thanksgiving.

The extremely light volume triggered a number of studies in the Quantifinder. They were all either bearish or neutral in nature. I took a closer look to try and discern what Friday's light volume might imply. In the 2/7/11 subscriber letter I looked at other instances where the SPX posted its highest close in 10 days on the lightest volume in 10 days (while above the 200ma). I have updated the results for that study below.

SPX closes at a 10-day high on the lightest NYSE volume in 10 days. Buy on close. Sell X days later. \$100k/trade. 2005 - 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	-13,719.37	34	20	14	58.82	1,375.15	2,506.08	-2,944.46	-10,777.36	0.47	0.67	-403.51
9	-20,605.61	34	20	14	58.82	1,250.22	2,380.80	-3,257.86	-10,726.30	0.38	0.55	-606.05
8	-20,988.46	34	20	14	58.82	1,226.60	3,766.50	-3,251.47	-6,266.32	0.38	0.54	-617.31
7	-26,556.02	34	18	16	52.94	1,122.80	3,814.86	-2,922.90	-6,731.78	0.38	0.43	-781.06
6	-27,137.40	36	15	21	41.67	1,139.85	3,720.00	-2,106.44	-5,582.85	0.54	0.39	-753.82
5	-25,885.63	37	13	24	35.14	1,163.11	2,248.74	-1,708.58	-4,943.40	0.68	0.37	-699.61
4	-18,810.72	39	14	25	35.90	844.20	1,668.42	-1,225.18	-3,281.90	0.69	0.39	-482.33
3	-22,319.25	40	17	23	42.50	715.37	2,716.53	-1,499.15	-3,887.84	0.48	0.35	-557.98
2	-20,289.10	43	16	27	37.21	681.55	2,205.03	-1,155.33	-3,595.20	0.59	0.35	-471.84
1	-10,460.93	50	22	28	44.00	349.51	2,211.54	-648.22	-2,492.10	0.54	0.42	-209.22

As you can see the numbers appear to suggest a moderate downside edge. But a closer examination of the equity curves tells a somewhat different story. Below I have pasted equity curves for both the 3-day and 1-day holding period.





The high price / low volume combo that once appeared to suggest a downside edge has simply not led to additional selling in the last few years. With this in mind I am not including this study on the Active List. I will monitor it a bit longer in the Quantifinder to see if the downside edge appears to reassert itself in the near future.

The fairly tight trading over the last 3 days caused the 3/10 Offset Historical Volatility Indicator came in at a very low 0.14 on Friday. I last discussed this indicator in detail in the 10/4/12 letter. I have copied that commentary below.

*I first introduced this indicator in July of 2009. It essentially takes a short 3-day measure of Historical Volatility and compares that to the 10-day measure of 3-days ago. Low readings indicate there has been a contraction in volatility. High readings indicate there has been an expansion. Anything at or below 0.25 is regarded as extremely low. Often after sharp contractions like this we see a volatility expansion take place.*

*In August of 2009 I published a study that found this condition created a favorable environment for trading Opening Range Breakouts (ORBs). A link to that study is below:*

[Quantifiable Edges ORBs Study.pdf](#)

*For anyone who is interested in seeing some techniques for actually trading these ORBs, there is a webinar from October 2010 on the subject on the videos page (subscribers only).*

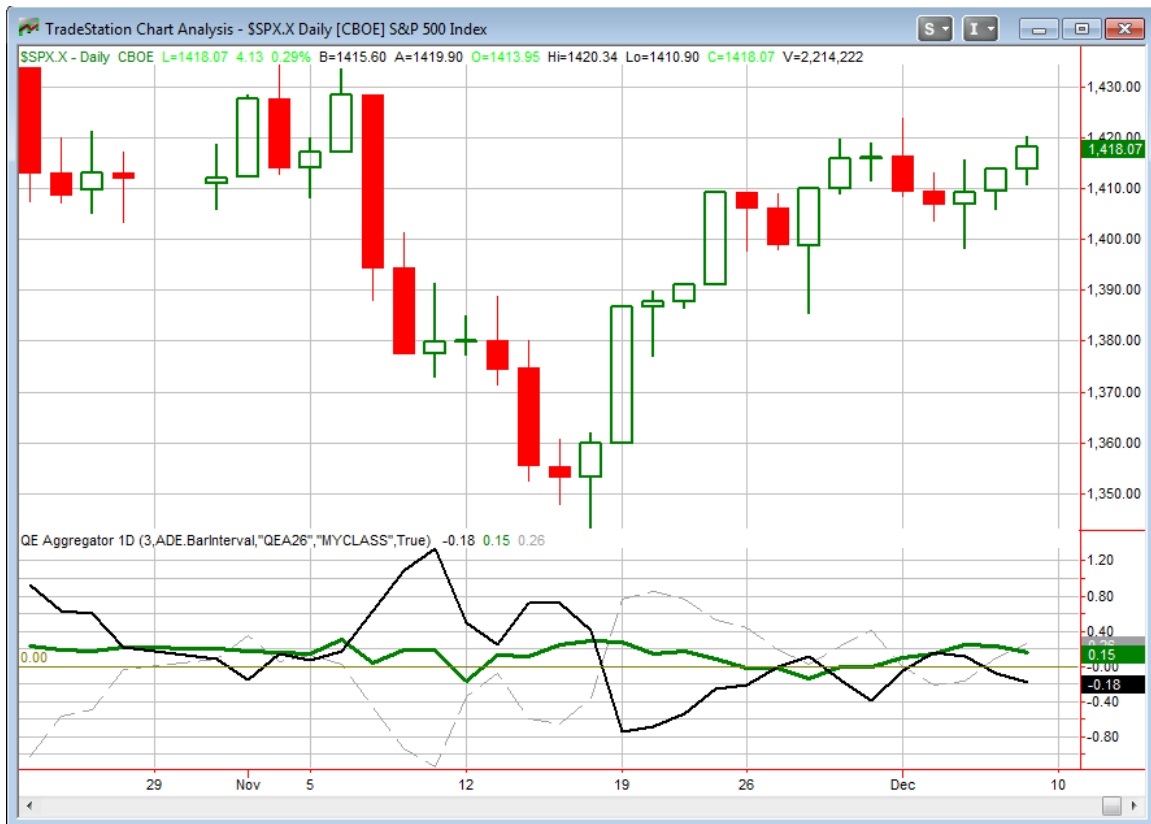
<http://www.quantifiableedges.com/members/videos.php>

*It's important to note that the 3/10 Offset HV indicator predicts volatility, not direction. For direction I look to the Aggregator. The Aggregator is currently neutral. Under these circumstances I could consider ORB trades in either direction. This would just be for a possible daytrade and is not something I will be tracking in the subscriber letter as an official trade idea. But even if you don't have any interest in attempting a daytrade, the low 3/10 Offset HV is worth noting. Because a volatility expansion (in either direction) is now likely, that means risk is elevated in open swing trade positions.*

*Of further note, the 3/10 Offset HV Calculation is available as part of the "QE Indicators/Functions for Tradestation". Subscribers may download it to include on their own charts. A link to the Indicators page is below, where you may download the User Guide or the Tradestation ELD.*

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

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



The green Aggregator line is again 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 still in negative territory. This means the SPX is overbought versus recent expectations. So net expectations are bullish but the SPX is overbought. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. This caused the Aggregator system to remain flat at the close.

Both of the active short-term studies are scheduled to expire on Monday. This is a very unusual situation as we normally have about 4-7 active short-term studies. If nothing new emerges the intermediate-term studies will keep expectations positive. But if new studies trigger they will have a large impact on expectations over the next few days. So it will be important to monitor Monday's action and see what studies emerge. The Differential Pivot will be 1,416.19 on Monday. This is just 0.1% below Friday's close. So despite the rise over the last few days SPX won't need to close much lower to move from overbought to oversold versus expectations.

Short-term evidence is not terribly compelling and with the SPX marginally overbought it seems like a good time to remain largely sidelined. I do hold a position in XIV from a few days ago, and I still like that position. VIX front month futures contango remains

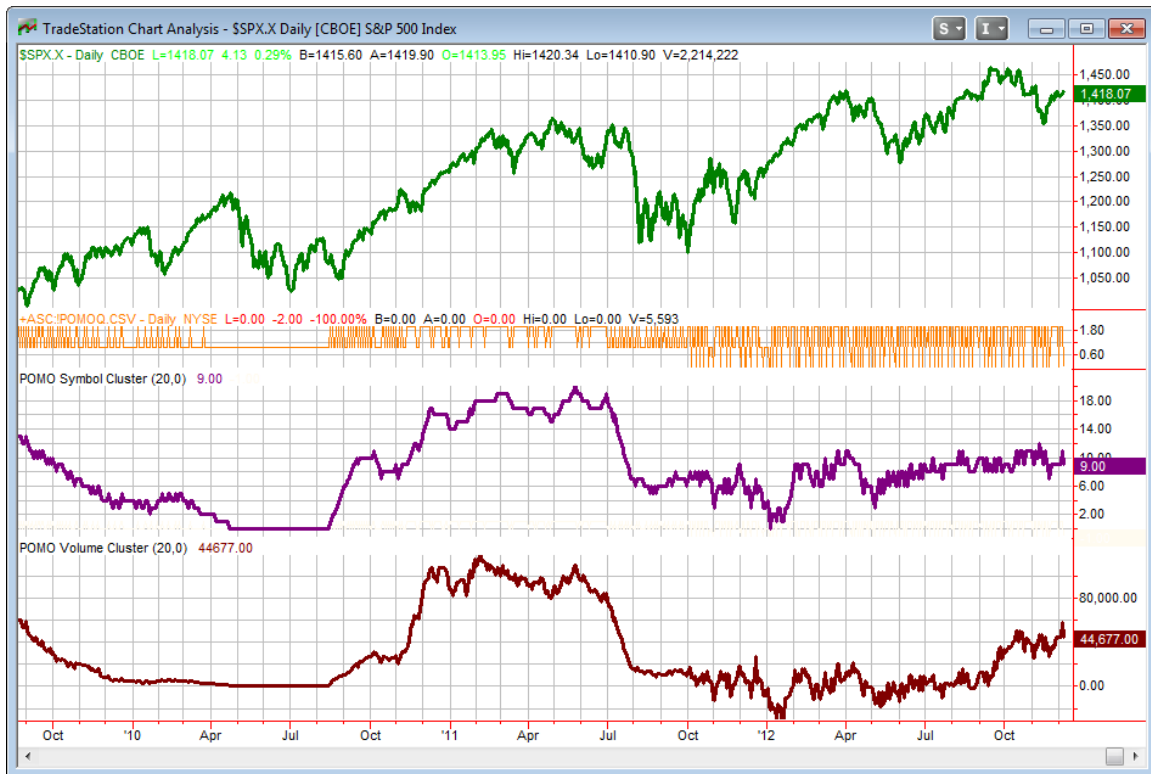
somewhat strong at 7.8%, SPX expectations are positive, and we will soon be entering a seasonal period prone to low volatility. I will likely continue to hold this position until 1) the Aggregator turns negative, 2) contango declines, or 3) the VIX gets strongly oversold short-term. None of those conditions currently exist, so I'll try and ride this winner a little longer. From an index standpoint, I'd prefer to see what evidence I uncover over the next few days before putting additional capital at risk.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 12/10– bullish***

The SPX rose for the 3<sup>rd</sup> week in a row, continuing its move off the mid-November lows. And after spending the last 13 days between the 200ma below and the 50ma above, it finally closed above the 50ma on Friday. With action relatively muted this week, nothing new of intermediate-term significance was noted by the Quantifinder.

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 again in the upper end of its expected QE3 range. While higher than Operation Twist, levels should remain below those of QE1 and QE2. We estimate there was a net inflow of about \$7.8 billion this past week.

This upcoming week we are expecting to see net buying every day except Thursday. This is expected to result in a net inflow of about \$12 billion.

While the short-term is unclear, 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. 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 tonight.](#)*

## **Current Open Trade Ideas**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Price</b>	<b>% Gain/Loss</b>	<b>Stop</b>	<b>Notes</b>
XIV(1/2)	12/5/2012	\$18.48	\$19.25	4.17%		Aggressive VIX

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