

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 24, 2012

Volume 5 Issue 245

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Long	75% Long XIV	Flat	Flat

Tonight's Research Points

- When opex week closes up 1%-2%, it is often followed by a short-term pullback.
- The Nasdaq is now back in a leading position, which has typically meant a favorable environment for stocks.

Short-term Outlook

The Bottom Line

Not out of the woods yet with the fiscal cliff but there is ample evidence for me to look to take on some long exposure. I expect liquidity, seasonality, and the now oversold price action to lead to a bounce in the next few days.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
December 24, 2012	Opex Week Up 1%-2%	1-5 days	Bearish	
December 21, 2012	Twas 3 Nights Before Christmas	1-8 days	Bullish	
December 12, 2012	5 days up > 200ma & < 50-high	1-10 days	Bullish	2.00%
Active - Long Term				
December 24, 2012	Nasdaq Leading SPX	int term	Bullish	
December 12, 2012	5 days up > 200ma & < 50-high	1-15 days	Bullish	2.80%
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.

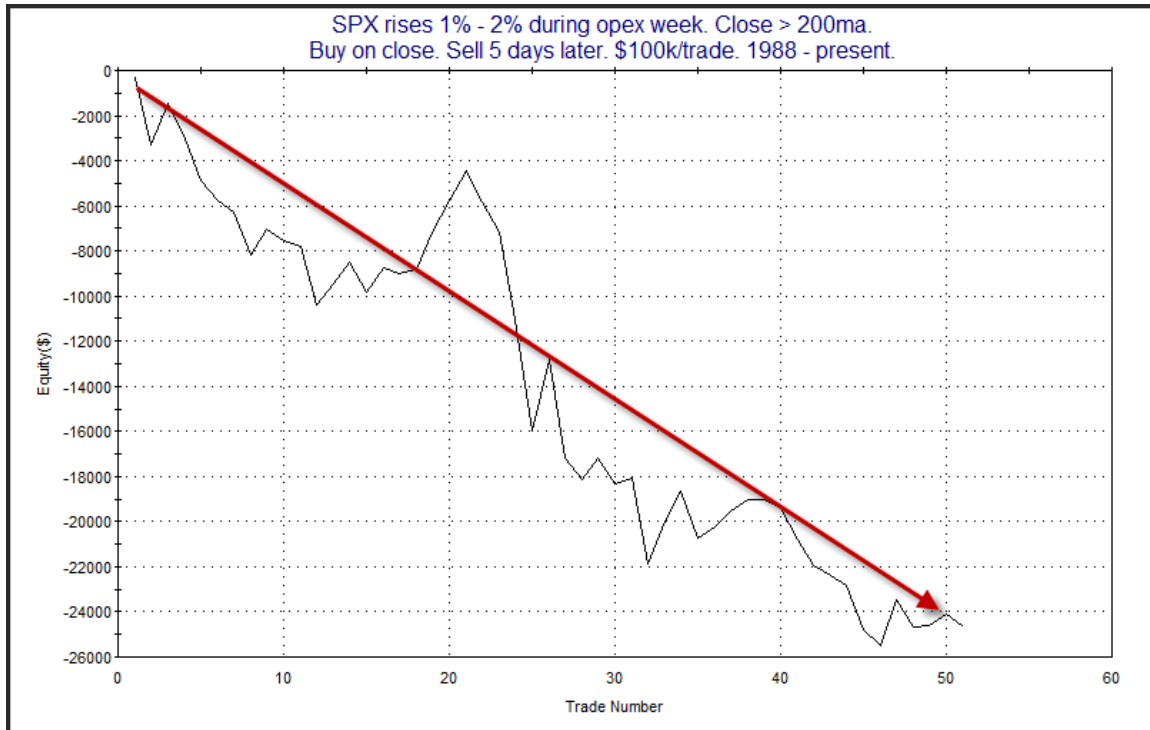
The Evidence

The market was dealt a blow when fiscal cliff negotiations hit a snag Thursday night. This made for a difficult open. But an afternoon rally saw the indices close near their intraday highs and reduced the damage some. The SPX lost 0.9%, the NASDAQ fell 1.0%, and the Russell 2000 declined 0.5%. Breadth was negative as the NYSE Up Issues % was 32% and the Up Volume % came in at 20%. Helped out by opex, total NYSE volume hit the highest level in several months.

Strong moves opex week will often be followed by a pullback the following week. This is something we saw in the 6/21/12 subscriber letter. I have updated the study from that letter below.

SPX rises 1% - 2% during opex week. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1988 - 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	-24,699.31	51	20	31	39.22	1,121.38	3,146.64	-1,520.22	-4,961.56	0.74	0.48	-484.30
4	-19,586.06	51	18	33	35.29	984.28	3,212.16	-1,130.40	-4,046.70	0.87	0.47	-384.04
3	-4,995.19	51	26	25	50.98	788.52	3,403.68	-1,019.87	-2,765.00	0.77	0.80	-97.94
2	-7,524.17	51	25	26	49.02	596.48	1,590.30	-862.93	-2,917.60	0.69	0.66	-147.53
1	-4,136.12	51	21	30	41.18	526.21	1,739.10	-506.22	-2,470.65	1.04	0.73	-81.10

The stats suggest a short-term downside edge. Below is a profit curve assuming a 5-day holding strategy.



There was definitely a bump for a few trades in the middle of the chart, but that was quickly righted. Overall the equity curve appears suitable enough to confirm the downside edge suggested by the stats table.

Of course it is unusual to have opex Friday occurring on the 21st – the latest possible date. And this negative seasonality is bumping up against the positive “3 Nights Before Christmas” and January Effect positive seasonality. Rather than try and choose which will prevail myself, I typically just place conflicting studies onto the Active List and let the Aggregator sort out which are likely to exert more influence.

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



Even with tonight's bearish study the green Aggregator line is still above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line shot up into positive territory. This means the SPX is now oversold versus recent expectations. So net expectations are positive 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 change from flat to long at the close.

Based on the current studies, expectations are set to remain bullish on Monday. Of course this could change if strong bearish evidence emerges. The Differential Pivot will be 1,438.46 on Monday. This is about 0.6% above Friday's close. So it will take a close higher of at least this much in order for the SPX to move from oversold to overbought versus expectations.

I like the long side here. Even with tonight's study there is decent seasonality and other evidence from the past few days suggesting an upside edge. And with the market now oversold risk/reward appears favorable. I will look to take on some long exposure on Monday.

Intermediate-term Outlook (2 weeks – 2 months)– updated 12/24– bullish

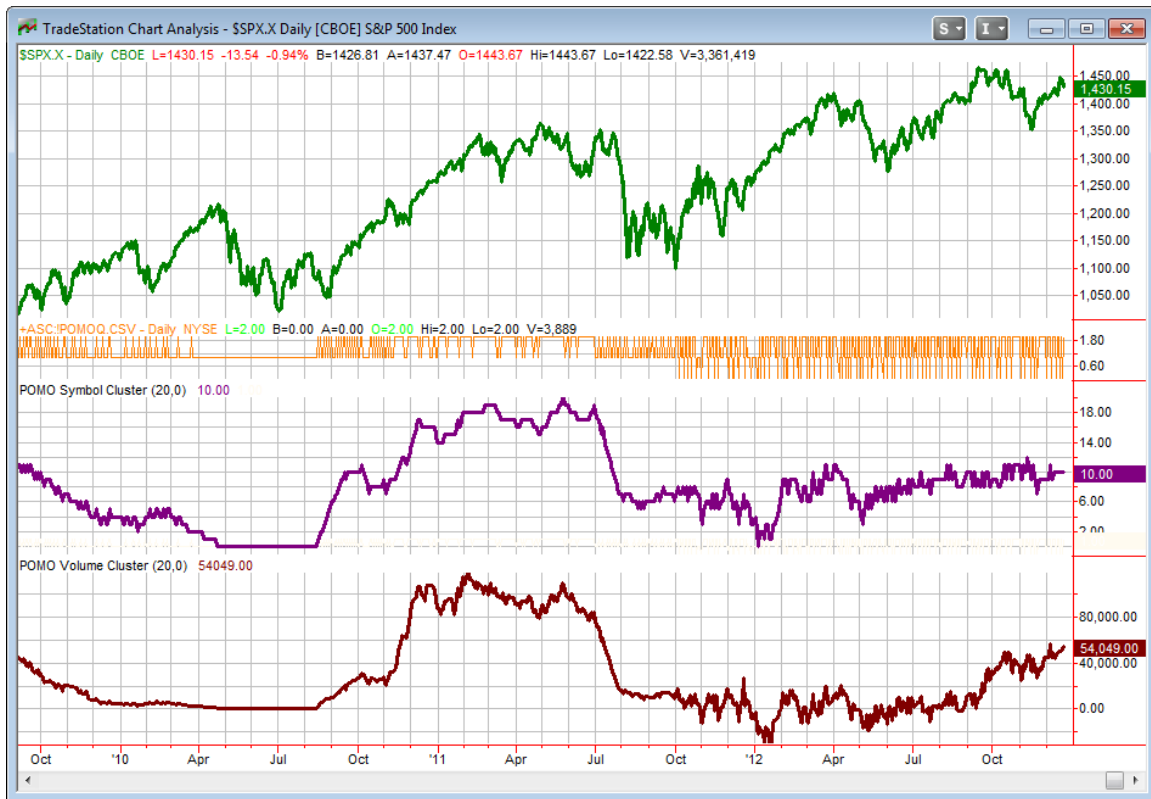
The “Most Wonderful Week of the Year” (being the most bullish historically) posted decent gains despite the pullback on Friday. SPX now sits only about 3% from its September high. If it can get there it will be interesting to see if any divergences occur (especially those related to breadth).

One bit of bullish news this week is that the NASDAQ was able to regain its leadership position after lagging all but one week 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.

There was also a little POMO news announced. The Fed had scheduled Dec 27th as a day that it would tentatively do some selling. On Friday that selling session was cancelled. So liquidity this week should be quite strong.

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 still remain below those of QE1 and QE2. And at this point it appears the lower amount of liquidity infusion is struggling to have as strong of an impact. We estimate there was a net inflow of about \$7 billion this past week.

This upcoming week we are expecting to see net buying all 4 days that the market is open. Total inflows are expected to be a very strong \$17 billion. This should provide a strong wind to the markets back at the end of the year and into early next year. (Of course there could be strong crosswinds as well in the form of a fiscal cliff.)

There still appears to be decent evidence that higher prices are likely over the next several weeks. Breadth has provided bullish clues. Liquidity is also anticipated to remain strong. Price studies and now Nasdaq leadership are also pointing higher. Of course even with all this bullish influence the government could throw a wrench in the works with the Fiscal Cliff. I'll continue to favor the long side, but will keep a close on new studies to see if bearish clues are emerging.

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.

SPY – buy ¼ index position @ \$142.79 LIMIT. Based on short-term outlook above, I will look to take on some SPY exposure on Monday.

SPY – buy ¼ index position @ \$142.40 LIMIT ON CLOSE. If Monday again closes lower and down at least this much, I will look to take on a 2nd lot at the close.

Current Open Trade Ideas

None

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