

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 7, 2013

Volume 6 Issue 4

## 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 VXO's extended stretch below its 10ma suggests the SPX should dip in the next 1-2 days.
- The recent strong breadth suggests further gains.
- QE3 is strengthening and should provide a nice backdrop in January and beyond.

## *Short-term Outlook*

### *The Bottom Line*

Evidence is mildly bullish but the market is still overbought. I'm flat. Should we get a pullback early in the week, I may look to start scaling in to a long position. I have no interest in shorting in this environment.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
January 7, 2013	Up Issue % > 75% 2 of last 3 days	1-2 days	Bullish	
January 7, 2013	VXO 15% below 10ma 3 days	1-2 days	Bearish	
January 4, 2013	SPX dn. Up issue % > 55%.	1-2 days	Bullish	1.00%
January 4, 2013	VXO 20% below 10ma	1-2 days	Bearish	-0.90%
January 3, 2013	50-day high breakout	1-5 days	Bullish	
<b>Active - Long Term</b>				
January 3, 2013	50-day high breakout. 90% up vol	1-25 days	Bullish	
January 3, 2013	VIX high stretch to low stretch	1-8 days	Bullish	
January 3, 2013	SPX & TNX high 50-day highs	1-20 days	Bearish	
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***

Friday saw moderate buying and some new index highs. The SPX gained 0.4%, the Nasdaq eeked out a 0.04% gain, and the Russell 2000 rose 0.75%. Breadth was strongly positive as the NYSE Up Issues % was 76% and the Up Volume % came in at 80%. Volume declined from Thursday's level.

The moderate action did not trigger a whole lot of studies, but there were a few interesting ones to consider.

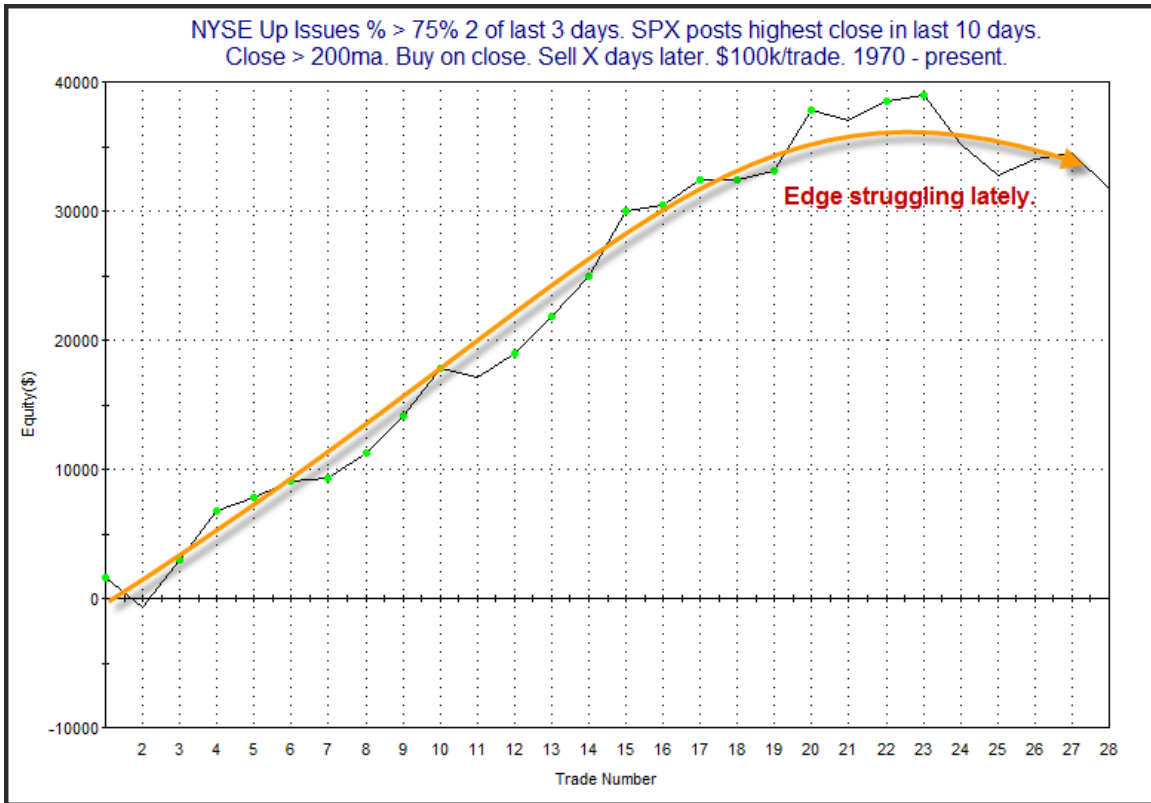
One study that appeared in the Quantifinder examined the strong breadth we have now seen in 2 of the last 3 days, and the fact that the market closed at a 10-day high. It was last seen in the 7/5/12 subscriber letter and has been updated below.

NYSE Up Issues % > 75% 2 of last 3 days. SPX posts highest close in last 10 days.  
Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1970 - 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	53,143.60	24	19	5	79.17	4,410.11	10,448.44	-6,129.71	-15,033.10	0.72	2.73	2,214.32
19	54,995.43	25	20	5	80.00	4,152.97	10,910.56	-5,612.80	-11,094.08	0.74	2.96	2,199.82
18	55,335.25	25	21	4	84.00	3,832.29	8,727.84	-6,285.70	-11,176.96	0.61	3.20	2,213.41
17	53,795.80	25	21	4	84.00	3,765.46	9,187.20	-6,319.72	-10,308.94	0.60	3.13	2,151.83
16	51,417.03	25	20	5	80.00	3,876.03	9,539.88	-5,220.70	-12,209.26	0.74	2.97	2,056.68
15	39,924.60	25	18	7	72.00	3,900.12	8,941.56	-4,325.36	-12,665.84	0.90	2.32	1,596.98
14	32,467.45	25	20	5	80.00	3,267.28	7,807.79	-6,575.63	-16,504.96	0.50	1.99	1,298.70
13	36,915.50	26	19	7	73.08	3,311.90	8,597.16	-3,715.80	-12,673.98	0.89	2.42	1,419.83
12	32,339.14	27	19	8	70.37	3,270.48	7,623.04	-3,725.00	-16,601.16	0.88	2.09	1,197.75
11	42,444.63	27	21	6	77.78	2,946.01	7,783.28	-3,236.92	-10,687.08	0.91	3.19	1,572.02
10	34,708.82	27	20	7	74.07	2,883.71	7,954.00	-3,280.78	-10,636.02	0.88	2.51	1,285.51
9	34,733.44	27	19	8	70.37	2,909.26	8,085.92	-2,567.81	-6,176.04	1.13	2.69	1,286.42
8	30,430.37	27	19	8	70.37	2,433.26	6,037.28	-1,975.20	-6,641.50	1.23	2.93	1,127.05
7	33,089.77	27	19	8	70.37	2,406.16	6,145.92	-1,578.40	-4,207.64	1.52	3.62	1,225.55
6	31,667.59	28	22	6	78.57	2,028.56	5,002.50	-2,160.12	-3,812.48	0.94	3.44	1,130.99
5	26,322.40	28	19	9	67.86	1,952.94	4,482.50	-1,198.17	-3,191.62	1.63	3.44	940.09
4	17,144.57	29	21	8	72.41	1,392.87	6,138.16	-1,513.21	-3,595.13	0.92	2.42	591.19
3	8,963.94	29	18	11	62.07	1,253.36	4,376.64	-1,236.05	-5,105.87	1.01	1.66	309.10
2	6,340.38	32	19	13	59.38	984.48	4,399.92	-951.14	-3,149.67	1.04	1.51	198.14
1	5,617.26	34	20	14	58.82	596.07	1,848.00	-450.29	-1,564.34	1.32	1.89	165.21

The only instance that did not close above the entry price at some point in the next 6 days triggered on 7/3/12.

As noted at the bottom, the consistency suggesting at least some short-term follow through is very strong. While the edge appears to persist for 3-4 weeks, a large portion of that edge has played out over the 1<sup>st</sup> 6 days. Below is a profit curve that assumes a 6-day exit.



This profit curve was extremely straight for a long period of time, but has seen a little stumble lately. I have included this study on the active list, but will be keeping a close eye on it for a while.

Friday we again saw the VIX and VXO close well below their recent mean. This next study was last seen in the 6/21/12 subscriber letter. It looks for stretches of 15% or more that have persisted for three days.

VXO closes over 15% below its 10ma for exactly the 3rd day in a row.  
Buy SPX on close. Sell X days later. \$100k/trade. 1987 - 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	-25,577.49	21	10	11	47.62	833.97	2,073.06	-3,083.38	-10,448.88	0.27	0.25	-1,217.98
4	-19,137.91	21	10	11	47.62	877.96	2,331.45	-2,537.95	-5,673.45	0.35	0.31	-911.33
3	-14,708.41	21	9	12	42.86	1,151.96	1,904.75	-2,089.67	-8,395.18	0.55	0.41	-700.40
2	-16,484.60	21	5	16	23.81	993.87	1,737.55	-1,340.87	-5,164.42	0.74	0.23	-784.98
1	-15,596.85	21	5	16	23.81	780.12	1,990.25	-1,218.59	-4,980.56	0.64	0.20	-742.71

**In only 3 instances SPX failed to close below the entry price on day 1 or day 2. All 3 continued higher and did not post a close below the entry price any time in the next month. The 3 instances took place on 7/18/94, 10/19/98, & 10/2/01.**

Based on the stats table there appears to be a downside inclination. I find the note at the bottom of the study to be especially interesting. Nearly every case has experienced an almost immediate pullback, but those that didn't went without pulling back for a long time. Below I have listed all instances assuming a 2-day exit strategy.

VXO closes over 15% below its 10ma for exactly the 3rd day in a row. Buy SPX on close. Sell 2 days later. \$100k/trade. 1987 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
11/02/87	Buy	\$255.75	(2.65%)	\$0.00
11/04/87	Sell	\$248.96		(\$5,075.18)
12/23/87	Buy	\$253.16	(3.00%)	\$0.00
12/28/87	Sell	\$245.57		(\$3,543.15)
11/14/90	Buy	\$320.39	(1.02%)	\$0.00
11/16/90	Sell	\$317.12		(\$1,687.92)
01/25/91	Buy	\$336.07	(0.07%)	\$395.01
01/29/91	Sell	\$335.84		(\$537.57)
07/18/94	Buy	\$448.55	0.68%	\$1,498.50
07/20/94	Sell	\$451.60		\$0.00
12/16/94	Buy	\$458.80	(0.37%)	\$0.00
12/20/94	Sell	\$457.10		(\$527.31)
10/19/98	Buy	\$1,062.40	0.71%	\$2,035.10
10/21/98	Sell	\$1,069.90		(\$404.20)
12/23/98	Buy	\$1,228.54	(0.25%)	\$241.38
12/28/98	Sell	\$1,225.48		(\$597.78)
10/02/01	Buy	\$1,051.33	1.74%	\$3,115.05
10/04/01	Sell	\$1,069.62		(\$935.75)
07/31/02	Buy	\$911.62	(5.20%)	\$0.00
08/02/02	Sell	\$864.24		(\$6,286.03)
08/19/02	Buy	\$950.70	(0.14%)	\$93.45
08/21/02	Sell	\$949.36		(\$2,034.90)
08/24/07	Buy	\$1,479.37	(3.18%)	\$0.00
08/28/07	Sell	\$1,432.36		(\$3,173.12)
09/20/07	Buy	\$1,518.75	(0.07%)	\$789.10
09/24/07	Sell	\$1,517.73		(\$169.00)
12/26/07	Buy	\$1,497.66	(1.28%)	\$0.00
12/28/07	Sell	\$1,478.49		(\$1,713.36)
11/05/08	Buy	\$952.77	(2.29%)	\$0.00
11/07/08	Sell	\$930.99		(\$5,515.12)
02/22/10	Buy	\$1,108.01	(0.25%)	\$51.30
02/24/10	Sell	\$1,105.24		(\$1,424.70)
06/17/10	Buy	\$1,116.04	(0.25%)	\$1,351.91
06/21/10	Sell	\$1,113.20		(\$694.20)
03/25/11	Buy	\$1,313.80	0.43%	\$451.44
03/29/11	Sell	\$1,319.44		(\$649.04)
07/01/11	Buy	\$1,339.67	(0.03%)	\$93.98
07/06/11	Sell	\$1,339.22		(\$647.50)
10/12/11	Buy	\$1,207.25	1.44%	\$1,423.52
10/14/11	Sell	\$1,224.58		(\$1,366.94)
06/20/12	Buy	\$1,355.69	(1.52%)	\$188.34
06/22/12	Sell	\$1,335.02		(\$2,283.44)
<b>Avg Runup: \$558 Avg Drawdown: -\$1,869</b>				

The fact that the average drawdown is well over 3x the size of the average run-up is also worth considering. All in all it appears the stretched VXO is suggesting a short-term pullback. I have included this study on the active list.

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



The green Aggregator line edged just barely back 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 quite negative. The negative reading means the SPX is overbought versus recent expectations. So net expectations are positive 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 turn flat at the close.

Based on the current studies, expectations are set to remain bullish on Monday. This could change if compelling bearish evidence emerges. The Differential Pivot will be *mildly inverted* at 1,469.04 on Monday. This is 0.2% *above* Friday's close. An inverted pivot means that the Differential Line would cross through 0 on a flat close. So it will

take a 0.2% gain on Monday in order for the SPX to remain overbought and the Differential Line to remain negative..

I'm flat right now. Many studies have suggested we could see more upside. The recent breakout to new 50-day highs has had some positive characteristics and we could see some nice follow-through. But after such a sharp move higher, and with the VIX now depressed, risk is a bit high. So I will stay sidelined on Monday. If we get a pullback, then I may look to start scaling in to a long position over the next few days.

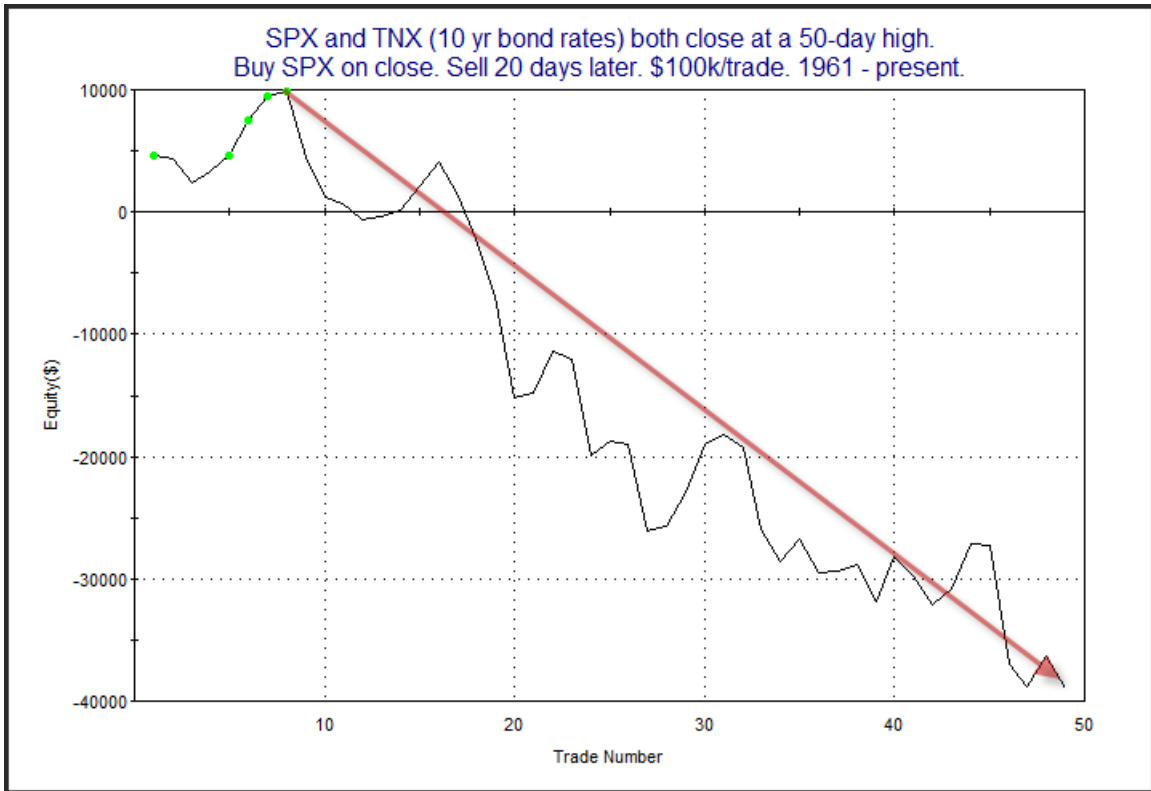
***Intermediate-term Outlook (2 weeks – 2 months)– updated 1/6– bullish***

We have had a strong start to the year, and the SPX is fast approaching multi-year highs. There were a few studies that triggered this past week with intermediate-term implications. I have copied them below. They all appeared in the 1/3/13 Letter.

*10-year bond rates hit new highs on Wednesday along with the SPX. Occurrences like this were last discussed in the 9/17/12 Subscriber Letter. I have updated the study from that letter below.*

SPX and TNX (10 yr bond rates) both close at a 50-day high. Buy SPX on close. Sell X days later. \$100k/trade. 1961 - 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
50	-38,989.36	39	18	21	46.15	3,336.89	9,293.13	-4,716.83	-11,866.50	0.71	0.61	-999.73
45	-35,031.68	40	17	23	42.50	3,930.32	8,170.47	-4,428.14	-11,540.20	0.89	0.66	-875.79
40	-17,905.70	42	20	22	47.62	3,810.93	7,101.51	-4,278.38	-10,971.10	0.89	0.81	-426.33
35	-28,420.27	44	20	24	45.45	3,171.99	9,093.59	-3,827.50	-9,558.36	0.83	0.69	-645.92
30	-15,240.84	45	18	27	40.00	3,609.78	8,122.50	-2,970.99	-6,689.55	1.22	0.81	-338.69
25	-5,876.84	47	20	27	42.55	3,044.37	7,845.48	-2,472.75	-6,261.07	1.23	0.91	-125.04
20	-38,906.10	49	24	25	48.98	1,811.55	4,616.92	-3,295.33	-9,695.84	0.55	0.53	-794.00
15	-28,466.05	49	25	24	51.02	1,663.00	3,500.32	-2,918.38	-9,608.60	0.57	0.59	-580.94
10	-9,416.00	54	31	23	57.41	1,321.47	3,263.44	-2,190.50	-8,683.66	0.60	0.81	-174.37
5	-5,348.22	71	38	33	53.52	1,025.53	5,231.46	-1,342.99	-6,088.44	0.76	0.88	-75.33

*Generally it seems that higher interest rates have often made bonds an attractive investment. This may have lead people to forsake stocks in favor of lower risk returns with improved yield. Implications of this study appear to be longer-term in nature. To help visualize how this edge has played out over time I have pasted below an equity curve using a 20-day exit strategy.*



*Despite recent wiggles, the downside edge appears squarely intact, and the curve is again making new lows.*

This next study was also copied from the 1/3/13 Letter.

*The strong breadth was also a plus. In the 9/7/12 subscriber letter I also looked at other breakouts that came on strong breadth. I have updated that study below.*

SPX closes at 50-day high after not having done so for at least 10 days.  
 NYSE Up Volume % > 90%. Buy SPX 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
50	63,310.05	10	9	1	90.00	7,381.21	19,845.80	-3,120.87	-3,120.87	2.37	21.29	6,331.01
45	62,957.58	10	9	1	90.00	7,394.87	17,945.20	-3,596.28	-3,596.28	2.06	18.51	6,295.76
40	64,714.92	10	9	1	90.00	7,304.47	20,950.80	-1,025.34	-1,025.34	7.12	64.12	6,471.49
35	63,159.21	10	9	1	90.00	7,164.51	18,961.80	-1,321.35	-1,321.35	5.42	48.80	6,315.92
30	56,881.22	12	11	1	91.67	5,209.10	11,920.74	-418.88	-418.88	12.44	136.79	4,740.10
25	50,932.12	13	11	2	84.62	5,144.86	12,045.67	-2,830.68	-2,993.76	1.82	10.00	3,917.86
20	44,780.32	13	9	4	69.23	6,187.09	13,393.77	-2,725.88	-6,770.72	2.27	5.11	3,444.64
15	36,540.80	13	9	4	69.23	5,204.87	8,150.48	-2,575.76	-5,148.00	2.02	4.55	2,810.83
10	32,452.71	13	9	4	69.23	4,355.96	10,507.25	-1,687.73	-4,090.24	2.58	5.81	2,496.36
9	28,008.60	13	9	3	69.23	3,846.78	8,413.73	-2,204.14	-4,101.68	1.75	5.24	2,154.51
8	24,463.57	13	9	4	69.23	3,735.85	8,524.75	-2,289.78	-3,923.40	1.63	3.67	1,881.81
7	25,043.60	13	10	3	76.92	3,378.92	6,026.80	-2,915.19	-3,954.60	1.16	3.86	1,926.43
6	23,928.70	13	10	3	76.92	2,981.44	6,819.80	-1,961.90	-4,106.70	1.52	5.07	1,840.67
5	26,862.79	13	10	3	76.92	3,048.58	8,516.82	-1,207.67	-3,295.50	2.52	8.41	2,066.37
4	17,905.59	13	10	3	76.92	2,376.65	6,716.71	-1,953.62	-4,894.50	1.22	4.06	1,377.35
3	20,250.22	13	10	3	76.92	2,198.87	6,740.50	-579.49	-1,555.56	3.79	12.65	1,557.71
2	16,988.41	13	11	2	84.62	1,630.14	4,028.44	-471.58	-733.41	3.46	19.01	1,306.80
1	11,863.19	13	10	3	76.92	1,266.21	2,755.52	-266.30	-475.20	4.75	15.85	912.55

*While such breakout action has been unusual, both short and long-term performance has been impressive. But even if we ignore the fresh breakouts, and simply look at instances of SPX hitting a 50-day high on 90% up volume, the stats are still strong. The study below was last seen in the 9/14/12 subscriber letter. Stats are updated.*

SPX closes at 50-day high. NYSE Up Volume % > 90%.  
Buy SPX 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
50	92,230.31	18	17	1	94.44	5,747.32	19,845.80	-5,474.10	-5,474.10	1.05	17.85	5,123.91
45	89,397.37	19	17	2	89.47	5,734.97	17,945.20	-4,048.58	-5,052.36	1.42	12.04	4,705.12
40	88,426.60	20	16	4	80.00	5,934.01	20,950.80	-1,629.39	-2,937.98	3.64	14.57	4,421.33
35	92,023.53	20	17	3	85.00	5,679.07	18,961.80	-1,506.89	-2,194.86	3.77	21.36	4,601.18
30	77,314.29	20	18	2	90.00	4,339.30	11,920.74	-396.52	-418.88	10.94	98.49	3,865.71
25	64,787.55	22	17	5	77.27	4,398.88	12,045.67	-1,998.68	-3,024.54	2.20	7.48	2,944.89
20	60,823.99	23	17	6	73.91	4,499.19	13,393.77	-2,610.37	-6,770.72	1.72	4.88	2,644.52
15	51,152.02	23	18	5	78.26	3,762.89	8,150.48	-3,316.01	-6,277.02	1.13	4.09	2,224.00
10	35,335.38	25	16	9	64.00	3,180.56	10,507.25	-1,728.18	-4,090.24	1.84	3.27	1,413.42
9	30,459.53	25	17	7	68.00	2,796.30	8,413.73	-2,439.66	-5,207.55	1.15	2.78	1,218.38
8	30,315.84	25	17	8	68.00	2,879.79	8,524.75	-2,330.07	-4,082.16	1.24	2.63	1,212.63
7	28,193.29	26	17	9	65.38	2,798.67	6,026.80	-2,153.79	-3,954.60	1.30	2.45	1,084.36
6	28,887.07	26	18	8	69.23	2,236.25	6,819.80	-1,420.68	-4,106.70	1.57	3.54	1,111.04
5	32,549.01	28	22	6	78.57	1,828.56	8,516.82	-1,279.87	-3,295.50	1.43	5.24	1,162.46
4	23,065.27	29	22	7	75.86	1,651.36	6,716.71	-1,894.95	-4,894.50	0.87	2.74	795.35
3	15,741.61	29	19	10	65.52	1,463.02	6,740.50	-1,205.57	-5,105.87	1.21	2.31	542.81
2	17,265.74	29	20	9	68.97	1,138.89	4,028.44	-612.44	-2,409.33	1.86	4.13	595.37
1	11,435.10	30	17	13	56.67	960.96	2,755.52	-377.02	-1,255.50	2.55	3.33	381.17

*No matter how you look at it, the extremely strong breadth in conjunction with the 50-day high appears to suggest an upside edge.*

Lastly, a VIX study that also suggested likely follow-through:

*But there is also good news with regards to the sharp drop in the VIX over the last couple of days. The study below was last seen in the 3/13/12 subscriber letter. The updated study results are below.*

VIX closes more than 10% below its 10ma after closing more than 10% above it one of the previous 4 days. SPX > 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1992 - 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	20,364.18	13	10	3	76.92	2,760.01	8,115.80	-2,411.98	-3,412.50	1.14	3.81	1,566.48
9	22,670.01	13	9	4	69.23	2,814.47	8,397.40	-665.05	-2,173.08	4.23	9.52	1,743.85
8	24,836.55	13	11	2	84.62	2,432.98	8,076.20	-963.09	-1,733.94	2.53	13.89	1,910.50
7	22,441.32	13	10	3	76.92	2,502.54	7,749.50	-861.37	-1,872.78	2.91	9.68	1,726.26
6	18,531.52	13	8	5	61.54	2,697.59	5,305.30	-609.84	-1,280.71	4.42	7.08	1,425.50
5	17,022.54	13	9	4	69.23	2,275.41	5,361.40	-864.04	-1,159.86	2.63	5.93	1,309.43
4	8,555.40	13	10	3	76.92	1,376.55	4,981.90	-1,736.69	-2,303.32	0.79	2.64	658.11
3	3,209.51	14	8	6	57.14	1,094.56	3,799.40	-924.50	-1,683.22	1.18	1.58	229.25
2	3,218.58	14	6	8	42.86	1,406.71	3,839.00	-652.71	-1,767.90	2.16	1.62	229.90
1	3,416.62	14	7	7	50.00	886.89	2,952.40	-398.80	-1,582.62	2.22	2.22	244.04

All 14 instances posted a close above the entry price at some point in the next 4 days.

*The market condition that would typically accompany such VIX movement is one where you see a strong rebound from a sharp decline during a long-term uptrend. Results over the first 2-3 days are somewhat sketchy, but once you get out beyond that they become more consistent and more powerful. Below I have listed all 13 instances with an eight day holding period.*

VIX closes more than 10% below 10ma after closing more than 10% above it one of the previous 4 days. SPX > 200ma.  
Buy SPX on close. Sell X days later. \$100k/trade. 1992 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
06/23/92	Buy	\$404.04	2.43%	\$2,880.02
07/06/92	Sell	\$413.84		(\$521.17)
07/26/96	Buy	\$635.89	4.44%	\$4,509.04
08/07/96	Sell	\$664.15		(\$1,047.19)
05/01/98	Buy	\$1,121.02	(0.19%)	\$845.50
05/13/98	Sell	\$1,118.86		(\$2,357.61)
01/07/00	Buy	\$1,441.47	0.28%	\$2,175.57
01/20/00	Sell	\$1,445.57		(\$992.91)
03/26/04	Buy	\$1,108.02	2.93%	\$3,829.50
04/07/04	Sell	\$1,140.48		\$0.00
05/26/06	Buy	\$1,280.16	(1.74%)	\$820.56
06/08/06	Sell	\$1,257.93		(\$3,508.44)
09/13/06	Buy	\$1,318.07	0.63%	\$846.00
09/25/06	Sell	\$1,326.37		(\$534.75)
03/09/07	Buy	\$1,402.85	2.29%	\$2,479.32
03/21/07	Sell	\$1,435.04		(\$2,759.77)
08/22/07	Buy	\$1,464.07	1.73%	\$2,198.44
09/04/07	Sell	\$1,489.42		(\$2,180.08)
07/14/09	Buy	\$905.84	8.11%	\$8,134.50
07/24/09	Sell	\$979.26		\$0.00
11/09/09	Buy	\$1,093.08	0.17%	\$1,875.51
11/19/09	Sell	\$1,094.90		(\$744.38)
12/03/10	Buy	\$1,224.71	0.86%	\$1,783.62
12/15/10	Sell	\$1,235.23		(\$422.01)
03/22/11	Buy	\$1,293.77	2.99%	\$3,394.16
04/01/11	Sell	\$1,332.41		(\$748.44)
03/12/12	Buy	\$1,371.09	1.58%	\$3,089.52
03/22/12	Sell	\$1,392.78		\$0.00

*I don't see anything alarming here. These results appear to confirm the upside edge. But since the first 1-3 days are a tossup, I simply placed this study on the intermediate-term list rather than the short-term list.*

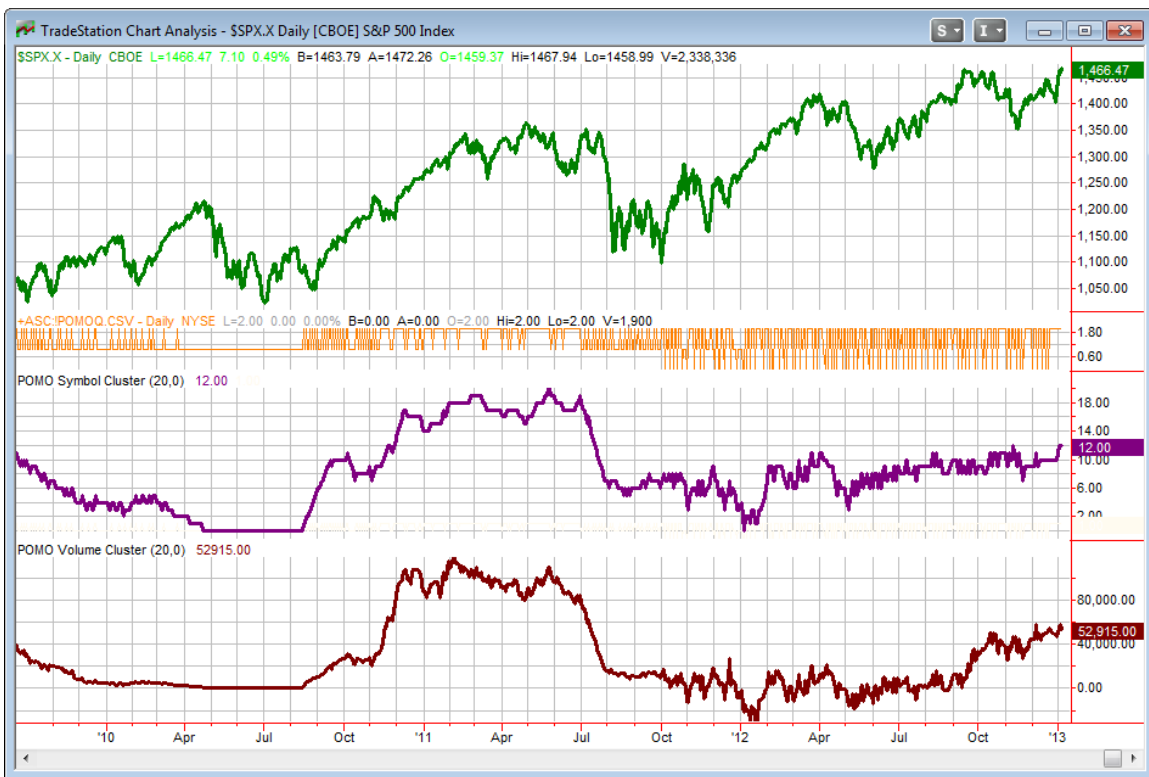
All 3 of these studies have been added to the intermediate-term active list.

Additionally, we had some very interesting developments this week with regards to QE3. Before I get into details, let's take a look at the chart I typically show and discuss.

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 as high as it has been since QE2. We estimate net inflows this past week to have been around \$12.8 billion. That is a very high number and enough that it would normally provide a nice bullish wind at the market's back in the following days.

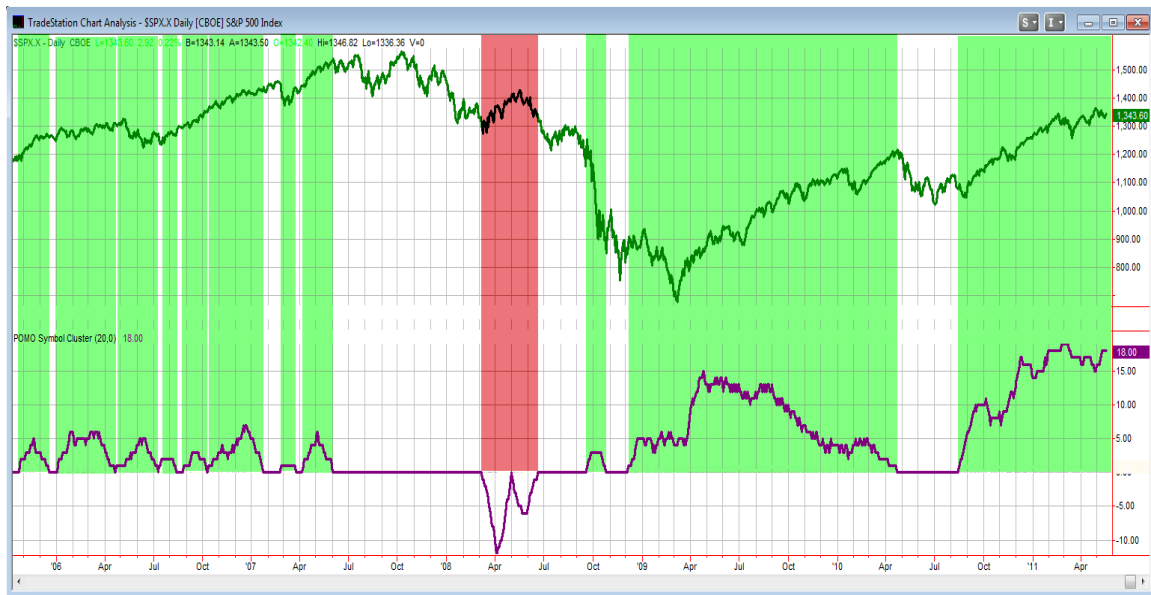
We saw some interesting developments with regards to QE three this week. The "bad news" was that after the release of the Fed minutes on Thursday there was some talk about possible end dates. Estimates of when fed liquidity infusions might end came in as low as 6-12 months from now. This did cause a bit of a pullback on Thursday from the highs of the day. But the good news that we saw develop over the course of the week was

that the "twist" appears to have either ended, or have been suspended. This means that the POMO schedule for January only calls for Fed buying. There is no selling scheduled in January.

This is expected to result in an inflow of about \$45 billion in POMO funds during the month of January. Additionally, the Fed is planning to extend the AMBS buying program to the tune of another \$40 billion in January. So we are expecting to see an \$85 billion liquidity infusion this month. That is much higher than anything we have seen since QE2 ended. It is higher than QE1 levels, and approaches the lower boundary of what we saw during a QE2 one-month period.

So for now it appears we will have a strong liquidity wind at the markets back. Over the last 7-8 years the market has flourished under such conditions. And while we know it won't last forever the same was known with other QE programs. In the chart on the previous page we see that the last sizable market decline, which occurred in 2011, began just as QE2 was ending.

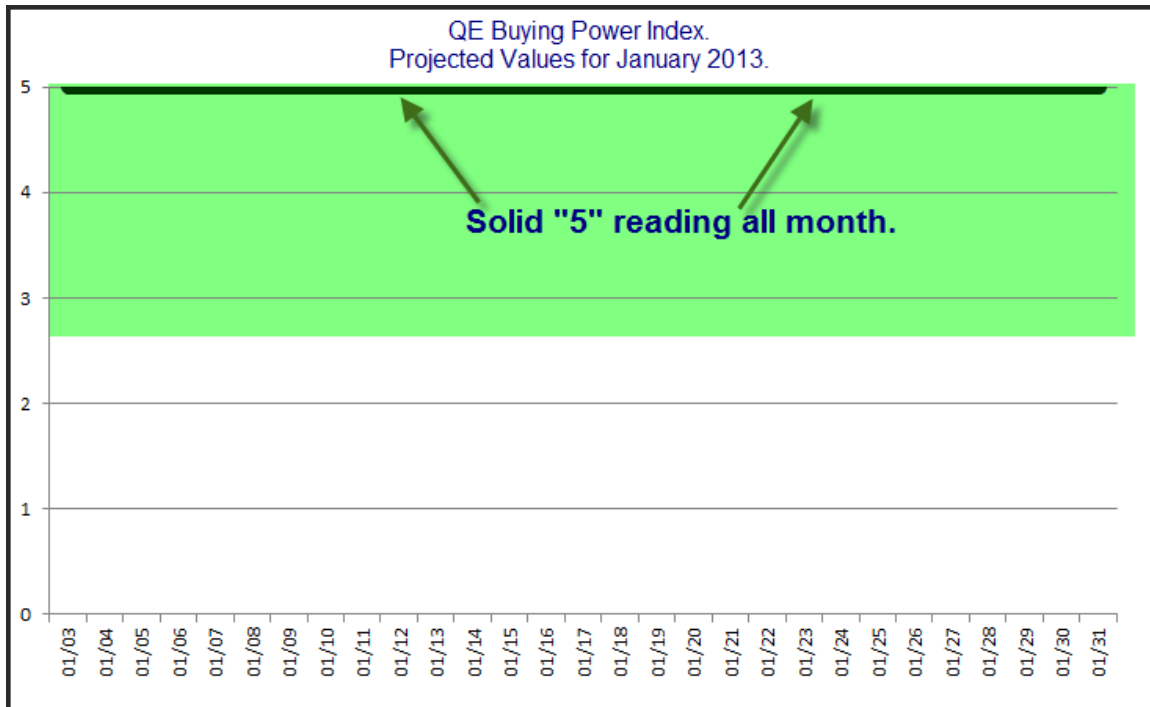
The chart below is one I created about a year and a half ago, and it goes back as far as POMO data is available. To better demonstrate the point, it only looks at our "days" indicator, rather than the "volume" one.



The post-QE1 decline in 2010 didn't actually occur until about a month after QE1 ended. And the earlier QE programs similarly saw nice moves higher during the injections, but the market struggled when those injections ended, or in the case of 2008, reversed.

So even if QE3 only lasts another six months, I believe it should provide us a nice backdrop for at least 4-5 months.

As for the QE Buying Power Index, which measures short-term flows, it is expected to remain at “5” for all of January.



This is a lot different looking than the chart has appeared in previous months. It will remain at 5 since there will be Fed buying every day, either AMBS, or AMBS and POMO. This means that the QE Buying Power Swing system will not be eligible to short this month, and will also be primed to buy all deep pullbacks.

One famous study that will get a fair amount of press this week is Yale Hirsch’s “1<sup>st</sup> 5 days” study. I did an examination of this study at the beginning of last year. To read my take on it you may use the link below:

[2012-01-03 QE Weekly Research Letter.pdf](#)

Overall there still appears to be decent technical evidence that higher prices are likely over the next several weeks. The only long-term bearish study we have is the one that looks at bond action from above. Breadth has provided bullish clues. Liquidity is very bullish. Price studies and Nasdaq leadership are also pointing higher. I’ll continue to favor the long side for now.

## **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**

*None*

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