

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 4, 2013

Volume 6 Issue 23

Market Overview



Signals Overview

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

Tonight's Research Points

- Strong POMO and AMBS liquidity infusions are expected to continue in February, helping provide a bullish backdrop.

Short-term Outlook

The Bottom Line

“Oversold” only lasted for one day. SPX is back at new highs and again a little overbought versus expectations. I am looking to exit my long position and wait for the next pullback to re-enter.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
February 1, 2013	1st 5 low in 2 weeks	1-4 days	Bullish	1.60%
February 1, 2013	Dn last 2 days of up month	1-5 days	Bullish	
January 31, 2013	Biggest drop in 10 days from 50-high	1-4 days	Bullish	
Active - Long Term				
January 29, 2013	up 5 & 50-day high. The down.	1-10 days	Bullish	
January 14, 2013	Breadth Divergence (from Tops Study)	int term	Bearish	
January 3, 2013	50-day high breakout. 90% up vol	1-25 days	Bullish	
January 3, 2013	SPX & TNX high 50-day highs	1-20 days	Bearish	
September 17, 2012	QE3	int term	Bullish	
February 1, 2012	Golden Cross	int term	Bullish	
Dropped Tonight				
January 31, 2013	Broad, shallow selloff from high	1-2 days	Bearish	
January 29, 2013	5 up then 1 dn > 200ma	1-4 days	Bullish	

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

The Evidence

February started out with a bang as the major indices all put in strong rallies. The SPX and the Russell 2000 each gained 1.0%, while the NASDAQ rose 1.2%. Breadth was strongly positive as the NYSE Up Issues % was 76% and the Up Volume % came in at 80%. Total NYSE did not rise with the market, and came in a little below Thursday's level.

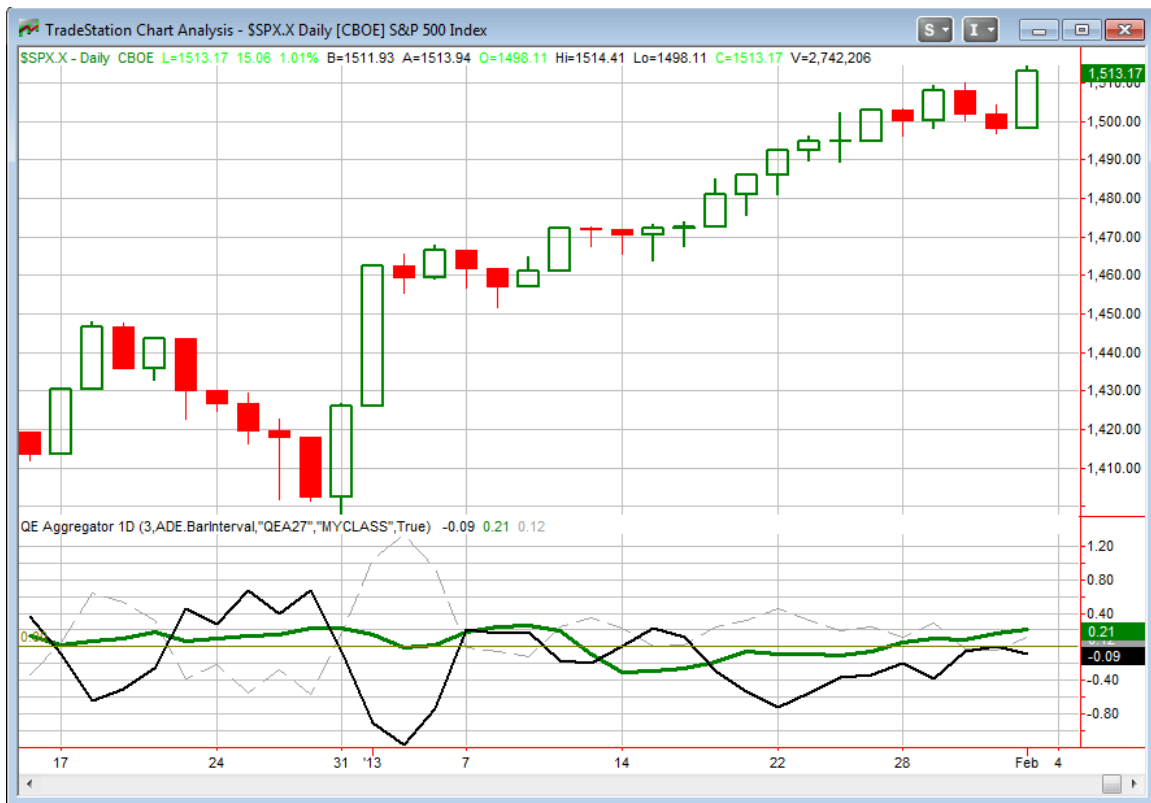
While the Quantifinder identified a few studies that appeared to have short-term bearish implications, a closer look showed that wasn't really the case. Those studies simply have not exhibited the bearish implications in recent instances that they had previously. One of these studies examined times when the SPX hit a 200-day high on the first Friday of the month. From 1998 to 2010 this was often followed by a pullback over the next several days. But over the last few years that has not been the case, and prior to 1998 it wasn't the case either. So if there was a downside edge for a while, it no longer appears to be in effect. This was also the case with another study that looked at the combination of a new high, strong breadth, and weak volume. So while at three o'clock on Friday it appeared we might have some studies to consider, I've instead eliminated them from the Quantifinder.

Eliminating studies may sound odd to newer subscribers, but it is really all part of the process I go through here at Quantifiable Edges. A big part of the reason that I frequently show equity curves, and almost always update my studies as soon as they occur, is that markets evolve. We've seen many examples of this over the years. And because a study is

no longer useful, doesn't mean that it never provided an edge. It just means that edge is no longer present. Either there was an environmental change that caused the edge to disappear, or perhaps it was widely identified and began to become overcrowded. The reason is not important. What's important is that we as traders identify when something is no longer working and adapt to it. And you can be sure that while some edges are losing their effectiveness, others are emerging. Long-term success as a trader is unlikely to be captured by learning one approach and sticking with that the rest of your life. Long-term success requires adaptation. And to adapt traders need to constantly observe with an open mind and remain curious about the market.

So no new short-term studies are being added to the active list tonight.

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



Tonight the green Aggregator line was again able to hold firm above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line quickly dropped back below 0. The negative reading means the SPX is overbought versus recent expectations. 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 change from long to flat at the close.

Based on the current studies expectations are set to remain bullish on Monday. This could change if additional bearish evidence emerges. The Differential Pivot will be 1,505.25 on Monday. This is 0.5% below Friday's close. So it will take a close lower of at least this much in order to move the SPX from overbought to oversold versus expectations.

Unfortunately, the quick pullback did not allow much time to build up a position. I did take on some exposure Thursday afternoon, but with the market now moving from oversold quickly back to overbought I plan to take my profits and await the next opportunity.

Intermediate-term Outlook (2 weeks – 2 months)– updated 2/4– bullish

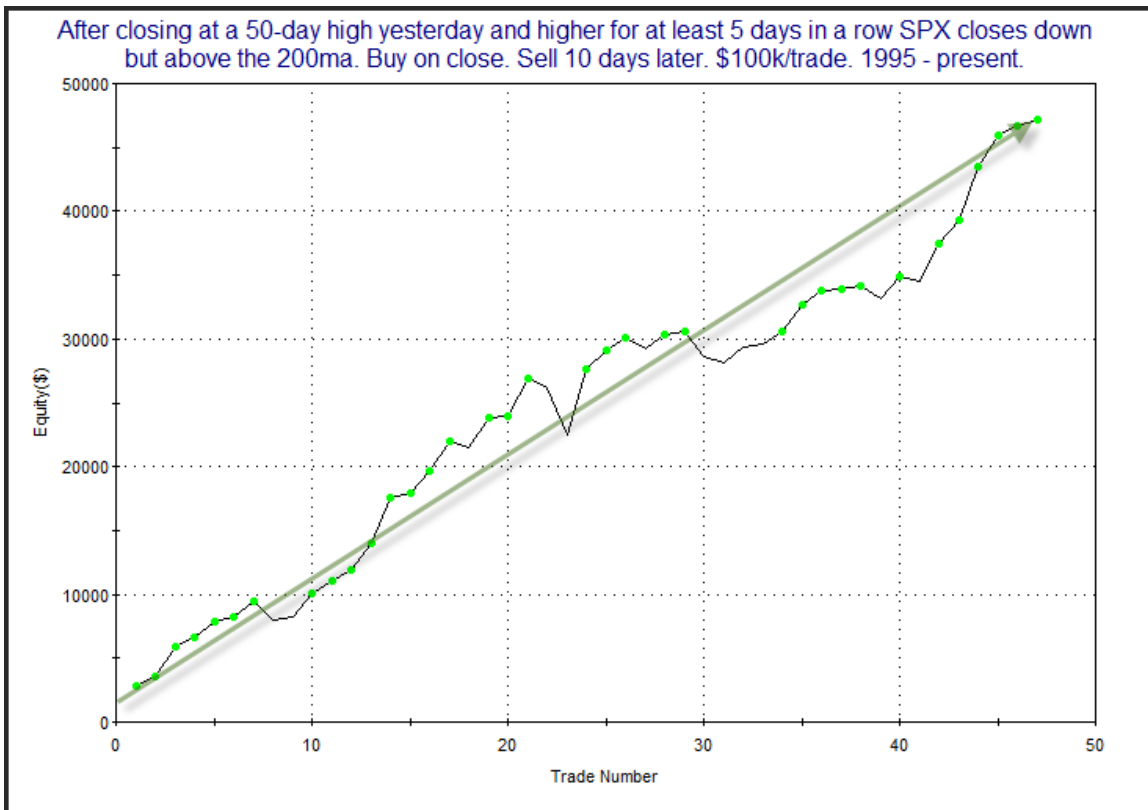
The rally continued as the SPX closed higher for the 5th week in a row. And with Friday closing at a new 200-day high once again there is no doubt the trend is still pointing up. We did have one new study trigger this week with intermediate-term implications. It was shown in the 1/29/12 letter. I have copied it below.

As everyone likely knows, prior to Monday's drop the SPX was locked in a persistent rally. I've shown a few different ways in the past that persistent rallies are unlikely to end abruptly. Instead they will either continue higher after a brief pullback, or action will become choppy prior to a sizable move lower. The study below was last seen in the 8/14/12 letter and it triggered on Monday. I have updated the results.

After closing at a 50-day high yesterday and higher for at least 5 days in a row SPX closes down but above the 200ma. Buy on close. Sell X days later. \$100k/trade. 1995 - 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	47,162.81	47	38	9	80.85	1,534.46	5,131.35	-1,238.51	-3,672.90	1.24	5.23	1,003.46
9	47,537.43	50	41	9	82.00	1,505.34	5,023.20	-1,575.73	-4,151.40	0.96	4.35	950.75
8	40,090.02	51	34	17	66.67	1,757.51	4,878.08	-1,156.77	-4,874.10	1.52	3.04	786.08
7	32,396.13	52	34	18	65.38	1,575.16	3,874.76	-1,175.52	-3,912.48	1.34	2.53	623.00
6	31,997.44	54	35	19	64.81	1,469.16	4,307.20	-1,022.26	-3,637.71	1.44	2.65	592.55
5	24,752.60	54	34	20	62.96	1,236.19	4,252.50	-863.89	-2,466.75	1.43	2.43	458.38
4	24,244.97	54	33	21	61.11	1,243.55	3,843.00	-799.63	-3,003.39	1.56	2.44	448.98
3	13,960.23	54	34	20	62.96	920.48	2,472.85	-866.80	-1,992.34	1.06	1.81	258.52
2	14,147.56	54	36	18	66.67	814.54	2,437.50	-843.10	-2,614.95	0.97	1.93	261.99
1	8,230.90	54	33	20	61.11	572.08	1,751.19	-532.39	-1,744.10	1.07	1.77	152.42

We see here a decent edge that becomes stronger and more consistent as you look out over the next several days. The 9-10 day time frame shows exceptional stats. {Below is the 10-day profit curve.}

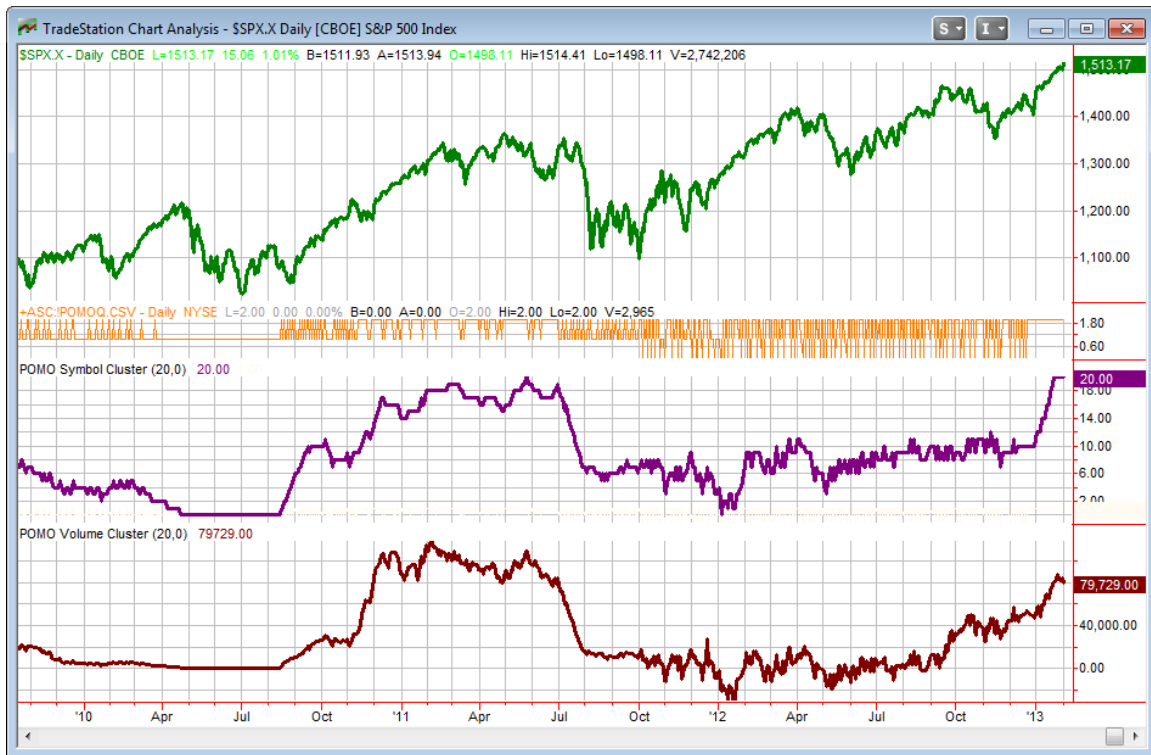


The strong upslope appears to confirm the bullish edge.

Since I updated the study of tops a few weeks ago I have been keeping a close eye on the number of new highs being made on the NYSE. While the SPX has been making new highs, and is now well above the mid-September high, the numbers of individual issues hitting new highs remains in a divergence. Friday only saw 412 new highs, which was well below the 483 peak back on September 14th. So the divergence remains in place for now, leaving open the possibility that a top could form leading to a major decline. A further expansion of new highs would greatly reduce the possibility of that happening in the next couple of months.

I update the intermediate-term POMO/QE3 chart each week. For those not familiar, below is a brief description.

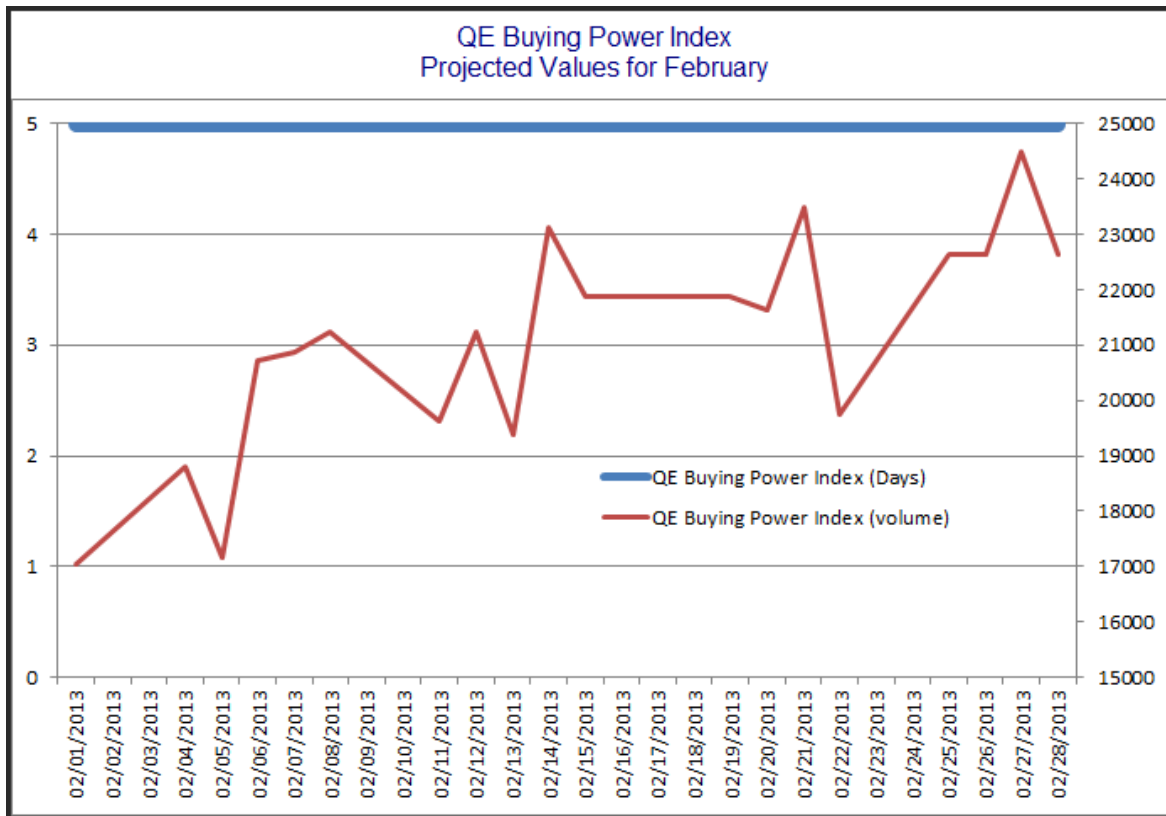
POMO stands for Permanent Open Market Operations and it is how the Fed has gone into the open market to buy securities over the last several years. The net effect of this buying is an influx of cash into the system. It appears a portion of that cash makes its way to the stock market and works as a bullish 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 near post-QE2 highs. And the days indicator is now maxed out at 20, which was a rarity even during QE2. We estimate net inflows this past week to have been around \$17 billion. That is a high number and enough that it would normally provide a nice bullish wind at the market's back in the following days.

This upcoming week is also expected to see strong liquidity again. Between POMO and AMBS we should see about a \$21 billion inflow. 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.

On Thursday the Fed released its schedule for POMO and AMBS buying in February. It is very close to January levels with \$44 billion in POMO and \$40 billion in AMBS purchasing anticipated. And as they did in January, there will be buying every day in February. I have simply used the "days" indicator to display the QE Buying Power Index over the last year or so. But with the days again set to be maxed out all month at "5" I decided to add volume measures to the chart as well. February's chart can be found below.



The red line is new. It looks at volume over the previous 5 days. It is scaled on the right hand side of the chart.

Traditionally for the QE Buying Power Index and POMO indicators I have used trade date for the measurement rather than settlement date. POMO buys and sells settle the next day so really it did not matter. But the new AMBS program that was initiated in September does not have next day settlement. Settlements instead are bunched and typically occur 45-60 days after purchase. Many of them occur on 3-5 days around the middle of the month. I am currently looking into using settlement date, rather than pay date for these transactions, considering which makes more sense, and how the shape of the indicators would change. So I may be making some changes to the measurements in the next few weeks. I'm happy to consider any thoughts or feedback readers have on this subject.

Intermediate-term evidence is similar to what we saw last week, and generally points to a likely continuation of the uptrend. We do have a breadth divergence to be aware of, and an active bond study is also warning of some intermediate-term downside. But the 1/3/13 breadth thrust study is bullish, liquidity is very strong, this week's study that looked at persistent moves to new highs is bullish, and the market is again at a new high as of Friday. So it appears this rally may have further to go. I'll 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

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	1/31/2013	\$149.70	\$151.24	1.03%		<i>sell @ \$151.24 limit</i>

I will look to exit SPY at the open as long as it does not gap down. If it does, I will give it a chance to fill, but will probably put a stop below the low of the 1st consolidation if we get a small gap down that does not fill in the first 20-30 minutes. Should I decide to incorporate such a stop, I will send out an intraday update.

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