

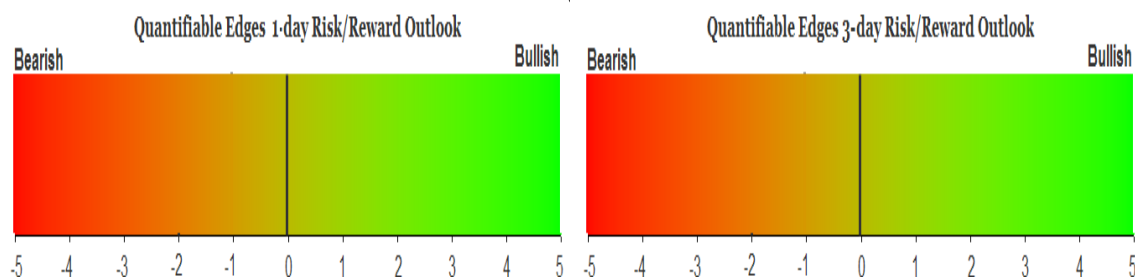
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 19, 2013

Volume 6 Issue 33

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 tight range over the last few days suggests we could see a sharp move in the next few.

Short-term Outlook

The Bottom Line

The quiet action has us without any substantial short-term edges. But we do have an indication that a sharp move could ensue in the next few days. If that happens we should see some decent edges emerge.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
Active - Long Term				
February 14, 2013	SPX & TNX 50-day highs.	1-20 days	Bearish	
January 29, 2013	up 5 & 50-day high. Then down.	1-10 days	Bullish	
January 14, 2013	Breadth Divergence (from Tops Study)	int term	Bearish	
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 almost looked like an actual selloff would happen. But in the end the market made up most of its losses and the major indices finished down small amounts. The SPX and Russell 2000 each lost 0.1%, while Nasdaq fell 0.2%. Breadth was mildly negative as the NYSE Up Issues % was 49% and the Up Volume % came in at 41%. Total NYSE volume rose as it typically does on opex Friday.

Nothing new and different emerged on Friday. New studies have been lacking lately and that will happen during times where the market is making small daily moves, especially when also chopping back and forth. So the lack of short-term evidence is not terribly surprising. I do want to talk about a couple of studies from Thursday’s letter.

The first one is below. It examined times where the SPX managed to consistently push higher on rising volume and make 50-day highs. It suggested decent odds of a continuation higher in the next few days.

SPX closes at a 50-day high and up for at least the 3rd day in a row. NYSE volume rises for at least 3 days in a row. Buy SPX 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
5	22,565.62	70	43	27	61.43	1,234.54	4,765.28	-1,130.36	-3,827.55	1.09	1.74	322.37
4	9,209.11	70	42	28	60.00	984.56	6,138.16	-1,147.94	-3,898.65	0.86	1.29	131.56
3	16,141.78	70	44	26	62.86	893.92	4,376.64	-891.95	-4,388.45	1.00	1.70	230.60
2	19,221.90	70	42	28	60.00	886.24	4,399.92	-642.86	-3,412.80	1.38	2.07	274.60
1	5,573.84	80	44	36	55.00	520.24	2,755.52	-481.02	-1,602.28	1.08	1.32	69.67

One analyst that I have become friends with over the years and whose work I have great respect for is Tom McClellan of [McClellan Financial Publications](#). On Friday I receive an email from Tom referring to this study. Tom asked if it might matter whether the setup triggered during opex week, since opex week can often see screwy volume numbers. So I ran the study and separated times when it occurring during opex week versus times it didn’t. First let’s look at times the setup triggered when it was NOT opex week.

SPX closes at a 50-day high and up for at least the 3rd day in a row. NYSE volume rises for at least 3 days in a row. It's **not** opex week. Buy SPX 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
5	19,226.65	53	32	21	60.38	1,412.27	4,765.28	-1,236.48	-3,827.55	1.14	1.74	362.77
4	10,009.03	53	33	20	62.26	1,096.41	6,138.16	-1,308.63	-3,898.65	0.84	1.38	188.85
3	15,535.33	53	34	19	64.15	1,000.07	4,376.64	-971.95	-4,388.45	1.03	1.84	293.12
2	17,896.59	53	32	21	60.38	1,000.25	4,399.92	-671.98	-3,412.80	1.49	2.27	337.67
1	11,510.89	60	37	23	61.67	580.58	2,755.52	-433.50	-1,071.43	1.34	2.15	191.85

Numbers here look better than the first study. Which of course means opex week is not going to fare as well. Below are those results.

SPX closes at a 50-day high and up for at least the 3rd day in a row. NYSE volume rises for at least 3 days in a row. It is opex week. Buy SPX 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
5	1,819.12	18	11	7	61.11	717.52	1,535.64	-867.65	-2,339.81	0.83	1.30	101.06
4	-1,951.60	18	9	9	50.00	574.41	848.61	-791.26	-2,780.64	0.73	0.73	-108.42
3	-54.34	18	10	8	55.56	533.01	1,118.60	-673.06	-2,750.40	0.79	0.99	-3.02
2	1,372.51	18	11	7	61.11	478.28	1,466.40	-555.50	-1,871.28	0.86	1.35	76.25
1	-5,937.05	20	7	13	35.00	201.31	571.38	-565.10	-1,602.28	0.36	0.19	-296.85

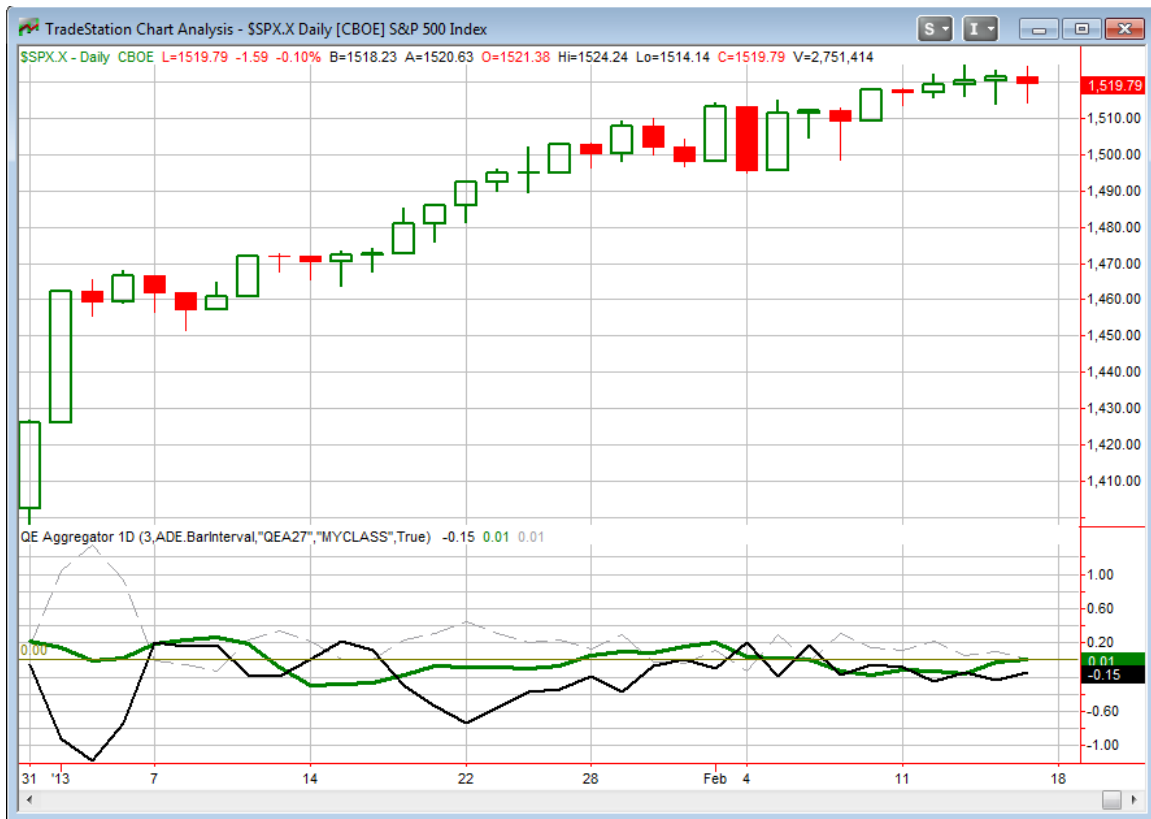
This is what triggered on Thursday. It appears that opex activity may contaminate the volume edge. I have not typically made this distinction in my volume studies, but it may be worth examining them in the future with an opex-week filter. So subscribers can expect to some volume studies in the future broken out this way.

The 3/10 offset HV remains extremely low at just 0.13. That is still at a level that is often followed by a sharp move in the following days. I also discussed this in some detail in Thursday's letter. Rather than repeat the whole thing here I have simply provided a link to Thursday's letter if anyone wants to review it.

[2013-02-15 QE Subscriber Letter.pdf](#)

Since I decided to eliminate Thursday's study that I discussed above, we will now be left without any substantial short-term studies. Of course there are still a few intermediate-term studies.

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



Without any short-term evidence the green Aggregator line inched just slightly above zero. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line is still 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 turn flat at the close.

Based on the current studies expectations are set remain bullish on Monday. Of course without any short-term studies, Monday's action and the new studies that emerge will have a very large influence on those expectations. The Differential Pivot will be 1,513.99 on Monday. This is 0.4% below Friday's close. So it would take a decline of this much in order to move the differential line back above zero and the SPX to an oversold state.

The Aggregator is neutral and so am I. I'm waiting for the market to tip its hand before allocating heavily in any direction. So there is really nothing for me to do from an index trading standpoint until that happens.

Interestingly, there was one Catapult setup that triggered on Friday. It was in OXY. We haven't had any Catapult trades at all so far in 2013, so that tells you how unusual they are without a sharp market pullback. In looking at the current construction of the S&P 100, it does appear that a sharp multi-day market pullback could quickly lead to a number of triggers and a quick spike in the CBI. Of course I'll monitor any such action closely and will share applicable studies should such a thing occur.

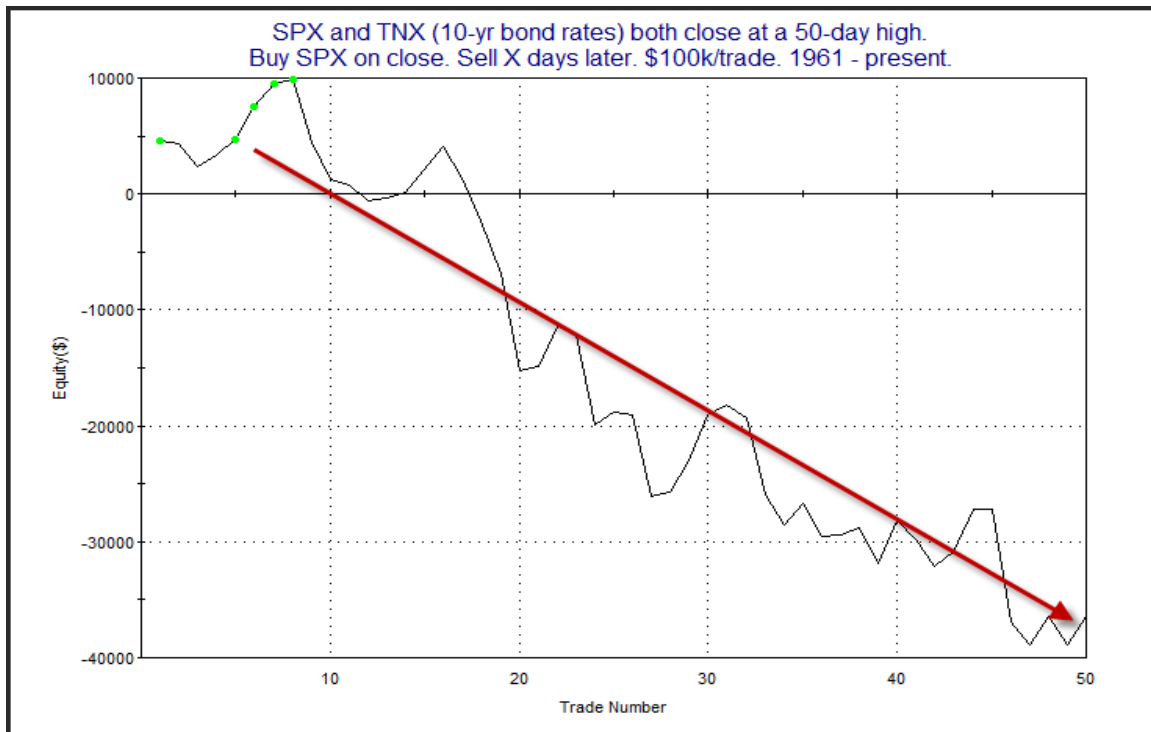
Intermediate-term Outlook (2 weeks – 2 months)– updated 2/19– bullish

SPX kept on with the grind higher this week and has now closed higher for the 7th week in a row. In the 2/14 letter we saw the study below trigger, which was the only new one with intermediate-term implications this week. I have copied the excerpt below from the 2/14/13 Subscriber Letter.

10-year bond rates hit new highs on Wednesday along with the SPX. This re-triggered the study below last discussed in the 1/3/13 Letter. Results are updated.

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	-2,682.88	48	21	27	43.75	3,051.49	7,845.48	-2,472.75	-6,261.07	1.23	0.96	-55.89
20	-36,479.18	50	25	25	50.00	1,836.17	4,616.92	-3,295.33	-9,695.84	0.56	0.56	-729.58
15	-26,262.86	50	26	24	52.00	1,683.78	3,500.32	-2,918.38	-9,608.60	0.58	0.63	-525.26
10	-7,733.70	56	33	23	58.93	1,292.36	3,263.44	-2,190.50	-8,683.66	0.59	0.85	-138.10
5	-4,455.40	74	40	34	54.05	998.96	5,231.46	-1,306.29	-6,088.44	0.76	0.90	-60.21

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.



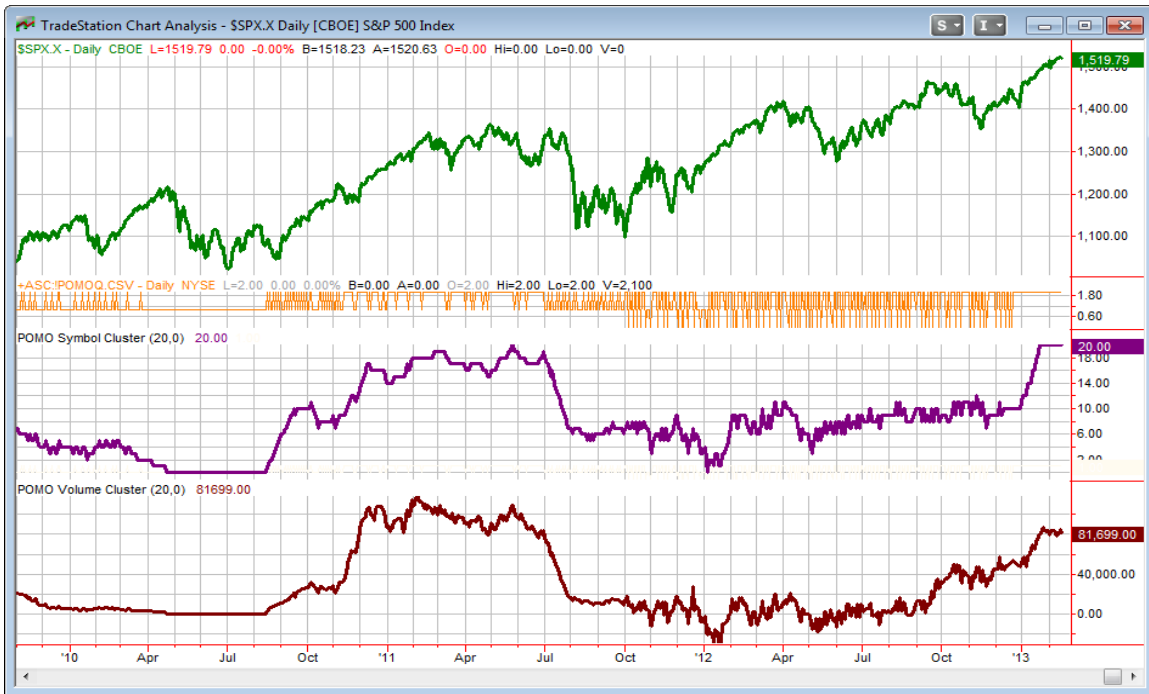
Despite recent wiggles, the downside edge appears intact.

Since I updated the QE Study of Tops in January (can be found on [members download page](#)) I have been keeping a close eye on the number of new highs being made on the NYSE. The SPX continues to make new highs but the numbers of individual issues hitting new highs remains in a divergence. Wednesday saw the highest number of new highs this week, with 332. This is well below the 400+ we've seen a few times so far in 2013 and far under the peak number of 483 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. And despite the rise in the SPX this week, this indicator continues to look weak. An expansion of new highs above the 483 level would greatly reduce the possibility of a major decline in the next few months.

I update the intermediate-term POMO/QE 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 still maxed out at 20, which was a rarity even during QE2. We estimate net inflows this past week to have been around \$21.9 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 \$17.6 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.

I am still looking into possibly using the full SOMA data to create a more comprehensive indicator than the QE Buying Power Index. (Details on this are in last week's letter.) It would not completely replace the QE Buying Power Index, since this data is only

available on a weekly basis, rather than daily. Still, the weekly data would be more inclusive, and may provide additional insights. As I mentioned last week, any subscribers that would like to offer input may feel free to e-mail me and I will provide them with the data.

Intermediate-term evidence remains mostly positive. We do have a breadth divergence to be aware of, but liquidity and momentum are both strong, and the market is again at a new high. 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

New

OXY – buy 1/3 position @ \$84.71 limit

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 1(OXY)

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.

OXY – buy 1/3 Catapult position @ \$84.71 limit. This is a Catapult trade setup from above.

Current Open Trade Ideas

none

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