

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 11, 2013

Volume 6 Issue 47

## 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 extremely low VXO is suggesting a market pullback.
- March Op-Ex week has historically been very strong, especially Mon-Thurs.
- 5 consecutive higher highs often suggest a pullback – but not when SPX is hitting a 50-day high.

## Short-term Outlook

### The Bottom Line

Song remains the same. Expectations are higher, but the market is overbought, leaving risk/reward poor. For me it is still a matter of waiting, observing, and being ready to pounce when the next strongly favorable opportunity arises.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
March 11, 2013	March OpEx seasonally strong	1-4 days	Bullish	1.70%
March 11, 2013	SPX & TNX 50-day highs.	1-20 days	Bearish	
<b>Active - Long Term</b>				
February 21, 2013	1st 5 low in 10 days. Yest 20-high.	1-11 days	Bullish	
February 14, 2013	SPX & TNX 50-day highs.	1-20 days	Bearish	
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.

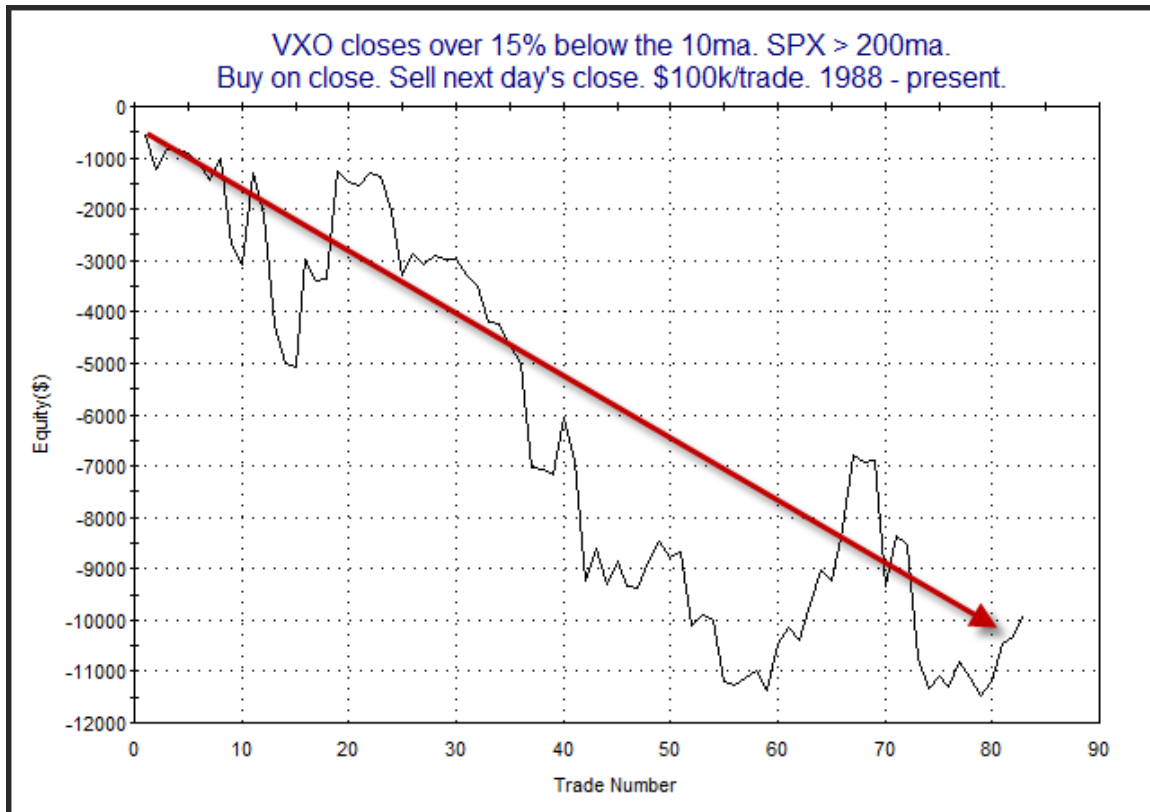
***The Evidence***

Friday saw a strong gap up thanks to a positive employment report, then a sharp pullback that gave away those gains in about 45 minutes, and then a rally that persisted through most of the day that saw the market close up near where it opened. The SPX finished up 0.5%, the Nasdaq rallied 0.4% and the Russell 2000 gained 0.9%. Breadth was squarely positive as the NYSE Up Issues % was 67% and the Up Volume % came in at 67% also. Total NYSE volume declined a little from Thursday's level.

One study that triggered again was one I highlighted a few nights ago in the 3/6/13 letter that looked at the strong stretch in the VXO. It closed 17% below its 10ma on Friday (and at the lowest level of the last 10 days as well). Such rapid drops in the VXO are often followed by a move lower in the SPX. Stats below are again updated.

VXO closes over 15% below the 10ma. SPX > 200ma. Buy on close. Sell next day's close. \$100k/trade. 1988 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	(\$9,893.92)	Profit Factor	0.67
Gross Profit	\$19,657.66	Gross Loss	(\$29,551.58)
Total Number of Trades	83	Percent Profitable	39.76%
Winning Trades	33	Losing Trades	50
Even Trades	0		
Avg. Trade Net Profit	(\$119.20)	Ratio Avg. Win:Avg. Loss	1.01
Avg. Winning Trade	\$595.69	Avg. Losing Trade	(\$591.03)
Largest Winning Trade	\$2,096.10	Largest Losing Trade	(\$2,447.06)

Stats here seem to suggest a decent downside inclination. But that inclination has not always been consistent. To get a better idea of how this edge has played out over time I have produced an equity curve below.



A while back I was close to tossing this study out of the Quantifinder. But in recent times it seemed to be attempting to reassert its downside tendency. I would certainly prefer a smoother profit curve, and will be keeping a close eye on it, but will place it on the Active List again tonight.

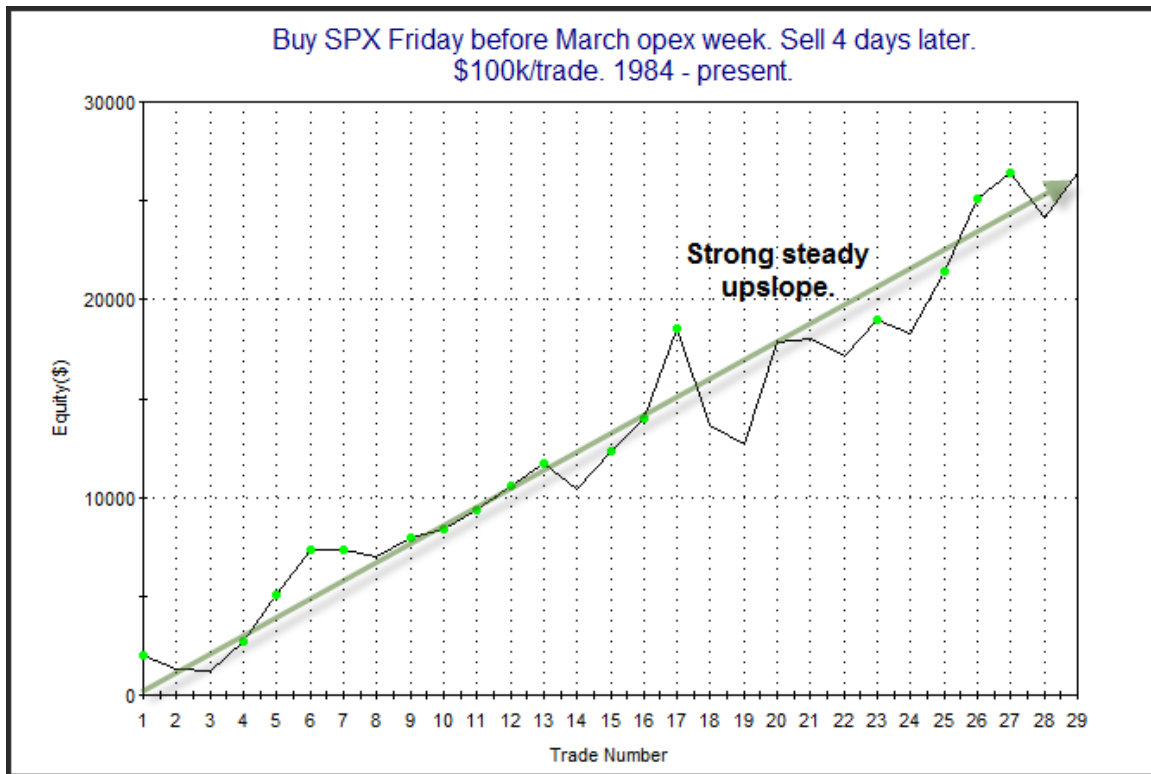
There is a seasonal influence that could have a bullish impact on the market this week. Op-ex week in general is pretty bullish. March, April, October, and December it has been especially so. S&P 500 options began trading in mid-1983. The table below is one I showed in the 3/12/12 Subscriber Letter. It goes back to 1984 and shows op-ex week performance broken down by month. All statistics are updated.

Op-Ex Week Performance by Month. 1984 - present. \$100k/trade. (Excludes September 2001)												
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
12	22,772.93	29	23	6	79.31	1,358.61	5,868.16	-1,412.53	-4,176.33	0.96	3.69	785.27
11	-828.54	29	17	12	58.62	1,355.92	3,718.25	-1,989.93	-8,351.64	0.68	0.97	-28.57
10	22,735.08	29	21	8	72.41	2,335.39	7,282.10	-3,288.50	-9,109.98	0.71	1.86	783.97
9	10,714.77	28	17	11	60.71	1,810.77	5,313.08	-1,515.30	-4,975.04	1.06	1.64	382.67
8	5,258.03	29	17	12	58.62	1,445.89	4,329.72	-1,610.18	-4,643.52	0.90	1.27	181.31
7	-4,108.73	29	13	15	44.83	1,531.20	6,921.25	-1,600.96	-7,953.12	0.96	0.83	-141.68
6	-879.88	29	16	13	55.17	1,257.62	3,786.09	-1,615.52	-3,998.19	0.78	0.96	-30.34
5	185.01	29	14	15	48.28	2,029.21	4,850.40	-1,881.60	-4,959.45	1.08	1.01	6.38
4	28,080.18	29	19	10	65.52	2,271.86	5,731.96	-1,508.53	-3,580.15	1.51	2.86	968.28
3	24,281.92	29	19	10	65.52	2,117.29	7,515.60	-1,594.66	-6,711.66	1.33	2.52	837.31
2	7,110.33	30	17	13	56.67	1,440.68	3,096.72	-1,337.02	-6,814.80	1.08	1.41	237.01
1	8,366.68	30	15	15	50.00	2,177.49	5,389.00	-1,619.71	-5,383.93	1.34	1.34	278.89

While December has been more reliable, total gains have been the largest during April and then March op-ex. As I did in that 3/12/12 Subscriber Letter, I also broke down March performance in more detail below.

Buy SPX Friday before March opex week. Sell X days later. \$100k/trade. 1984 - 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	24,281.92	29	19	10	65.52	2,117.29	7,515.60	-1,594.66	-6,711.66	1.33	2.52	837.31
4	26,403.04	29	20	9	68.97	1,926.42	5,108.40	-1,347.26	-4,848.66	1.43	3.18	910.45
3	10,738.87	29	17	12	58.62	1,499.72	4,989.60	-1,229.70	-5,403.51	1.22	1.73	370.31
2	10,055.88	29	19	10	65.52	1,194.25	3,981.60	-1,263.48	-2,894.94	0.95	1.80	346.75
1	1,466.87	29	19	10	65.52	628.33	3,542.40	-1,047.14	-4,302.72	0.60	1.14	50.58
<p style="color: red; text-align: center;">There have only been 4 years in which SPX did not close above the entry price at some point during the week. They were 1986, 1991, 2001, and 2011.</p>												

The upside edge seems to pretty much play out by Thursday. Below is a visual representation of the Monday-Thursday returns.



Bottom line here is that seasonality this week could provide a bit of a wind at the markets' back.

Lastly, there were a couple of studies from way back in the 5/19/08 letter that popped up. I decided to take a fresh look at them tonight. They looked at the possible impact of 5 higher highs occurring. Back then I used SPX to run the study. Tonight I decided to change it to SPY, since that will often give a better representation of intraday highs and lows. The studies examined the impact of the position of the market when the 5 higher highs occurred. I broke it down again tonight. I wanted to see all times the 5 higher highs were accompanied by a 50-day high versus times they weren't. First let's look at times where 5 higher highs occur without a 50-day high.

SPY makes a higher high for the 5th day in a row, but not a 50-day intraday high. Buy 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
5	-22,594.50	54	26	28	48.15	1,485.44	8,382.48	-2,186.29	-6,714.00	0.68	0.63	-418.42
4	-39,434.58	54	21	33	38.89	1,158.58	3,317.60	-1,932.26	-7,879.83	0.60	0.38	-730.27
3	-13,857.78	54	27	27	50.00	1,150.56	4,059.44	-1,663.82	-4,560.85	0.69	0.69	-256.63
2	-1,088.69	54	27	27	50.00	1,007.81	5,364.26	-1,048.13	-2,399.36	0.96	0.96	-20.16
1	-3,381.27	54	23	31	42.59	649.26	3,057.76	-590.78	-2,245.23	1.10	0.82	-62.62

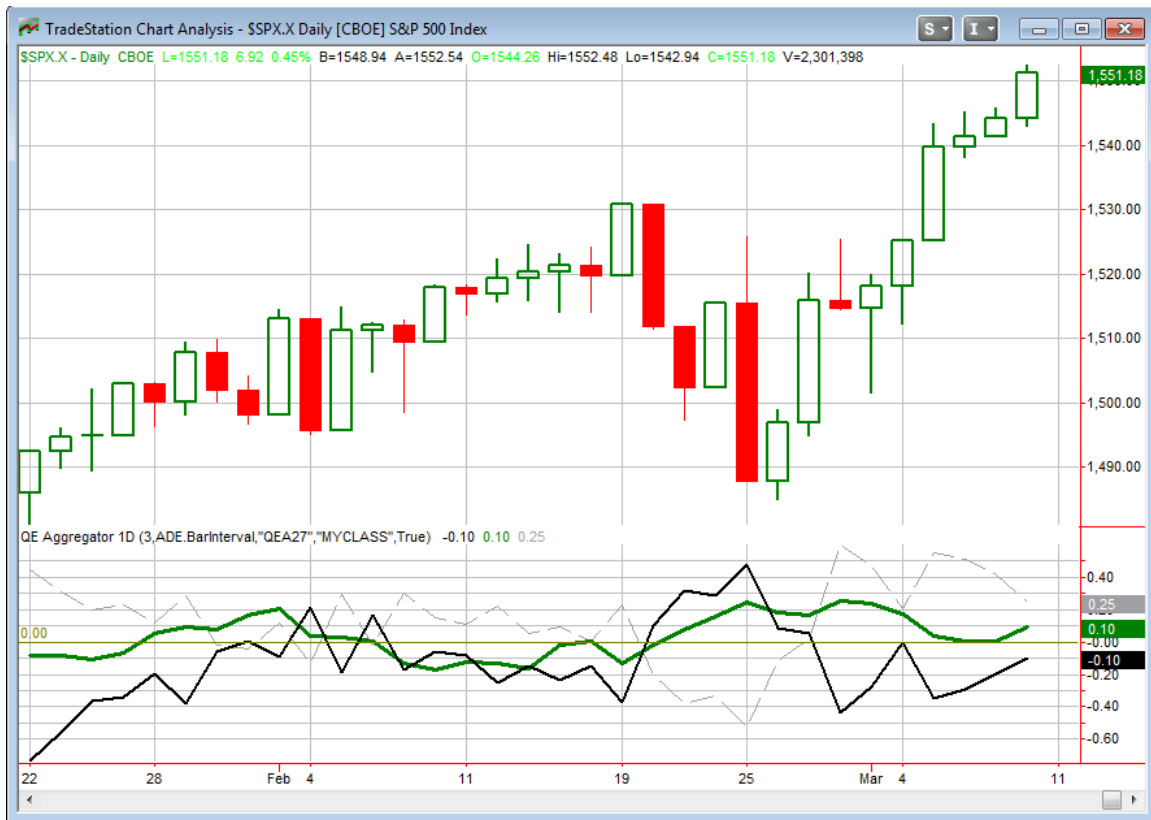
Stats over the 1<sup>st</sup> few days suggest a possible downside edge. After 5 higher highs the market will often need a breather.

But what of times (like now) when a strong uptrend exists and the market is also making a 50-day high? Those stats can be found below.

SPY makes a higher high for the 5th day in a row and a 50-day intraday high. Buy 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
5	314.75	54	25	29	46.30	1,234.43	3,452.80	-1,053.31	-3,514.00	1.17	1.01	5.83
4	-2,038.66	54	28	26	51.85	930.38	2,413.62	-1,080.35	-3,646.08	0.86	0.93	-37.75
3	-5,351.89	54	28	25	51.85	794.26	2,362.10	-1,103.65	-3,561.68	0.72	0.81	-99.11
2	-2,239.21	54	29	24	53.70	613.69	2,545.92	-834.85	-2,585.46	0.74	0.89	-41.47
1	-1,759.46	54	28	26	51.85	358.16	1,495.81	-453.38	-1,745.63	0.79	0.85	-32.58

Interestingly, the number of instances has been exactly the same. But with an intermediate-term rally also occurring the tendency to pull back no longer exists. So the 5 higher highs are really of no concern in situations like the current one.

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



Strong seasonality this week is helping to keep the green Aggregator Line 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. So 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.

Based on the current short-term studies, expectations are set to remain bullish on Monday. Of course this could change if more bearish evidence emerges. The Differential Pivot will be 1,544.78 on Monday. This is about 0.4% below Friday's close. So it would only take a close lower of this much in order to move the SPX from overbought to oversold versus expectations.

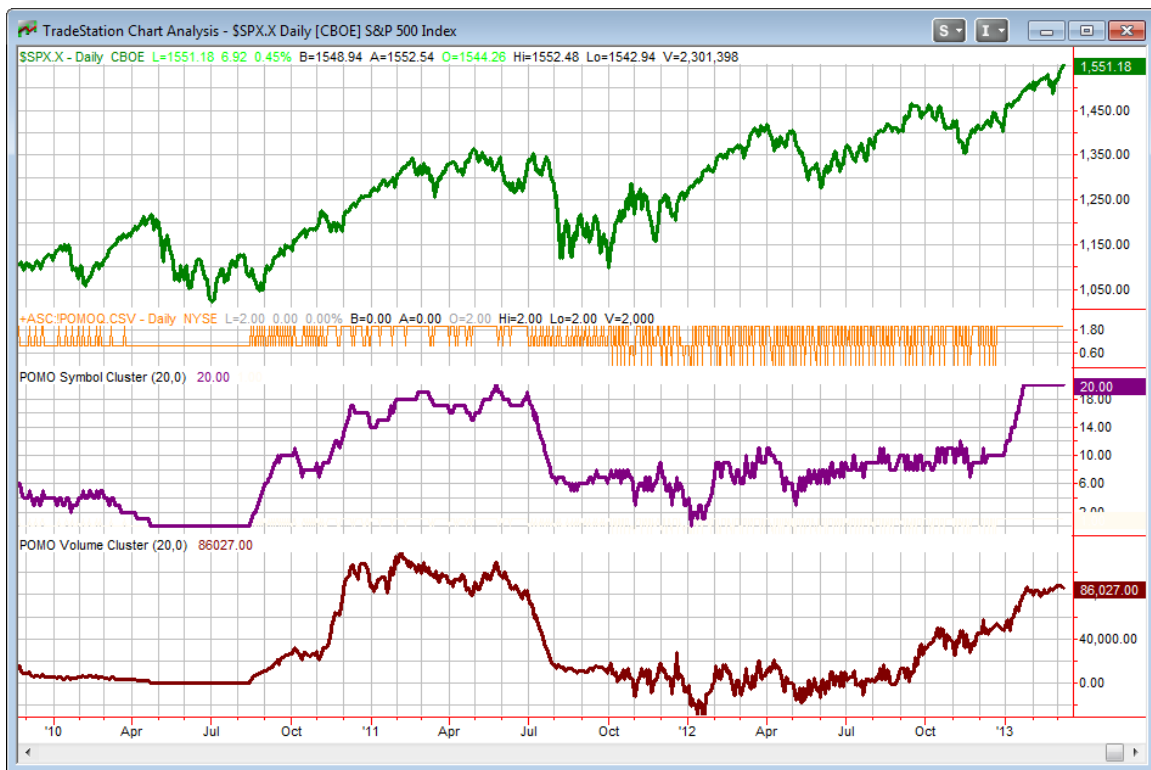
I feel like a broken record with my stance on short-term trading. The studies continue to suggest the market could continue higher. But the market has been overbought for so long that buying at this point offers poor risk/reward. So I'll continue to wait for a more favorable entry point.

**Intermediate-term Outlook (2 weeks – 2 months)– updated 3/11 – bullish**

With the SPX rising every day this past week it is again at multi-year highs. There is no doubt that the uptrend remains intact. And I am not compelled to fight it. Not a lot new to discuss this week so I am going to keep it short tonight.

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 nearly \$20 billion. That is a strong week. Numbers like this 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 \$22.6 billion inflow. The liquidity environment continues to be one that is favorable for the bulls.

Overall, intermediate-term evidence is mixed but leaning positive. On the negative side, bond action has not been favorable and the breadth divergence from the Study of Tops (available on the members download page) remains in place. But liquidity and momentum are both positive and they have trumped all in recent years. It still 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**

*None*

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