

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 22, 2013

Volume 6 Issue 76

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Long	100% Long XIV	Long	Flat

Tonight's Research Points

- The steep drop in VXO may have signaled trouble if the market was in a downtrend, but does not appear concerning during a long-term uptrend.
- Liquidity remains positive and the SOMA hit a new milestone high.

Short-term Outlook

The Bottom Line

Evidence is leaning bullish and SPX remains oversold. I like the long side and am holding a small long position.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
April 19, 2013	20-low > 200ma.	1-7 days	Bullish	2.00%
April 18, 2013	Unfill gap dn after unfill up.Close<2 ago	1-3 days	Bearish	
April 17, 2013	Sweet spot bounce	1-5 days	Bullish	2.90%
Active - Long Term				
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

The market bounced back strongly on Friday, with SPX more than making up for Thursday's losses. It posted a gain of 0.9% while the Nasdaq rose 1.3% and the Russell 2000 rallied 1.2%. Breadth was strongly positive as the NYSE Up Issues % was 72% and the Up Volume % came in at 73%. Total NYSE volume rose some, but was not as extreme as we often see on opex Friday.

Back and forth chop will often lead to a dearth of compelling evidence, and I am afraid Friday's action failed to generate anything substantial. But that does not mean that nothing notable or interesting transpired. The rally was accompanied by a very large drop in the VIX (and VXO, which is the old calculation for the VIX). Back in the 7/2/12 subscriber letter I noted that big drops in the VXO have had much different connotations depending on whether SPX is in a long-term uptrend or downtrend (as defined by its proximity to the 200ma). I decided to review those studies, which require a 15% 1-day VXO drop, in tonight's letter.

First let's consider what has followed when the large VXO drop has occurred during a long-term downtrend.

VXO closes down over 15%. SPX < 200ma. Buy SPX 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	-17,347.66	22	11	11	50.00	2,554.44	6,915.44	-4,131.50	-13,784.48	0.62	0.62	-788.53
4	-25,727.59	24	13	11	54.17	1,704.02	4,104.78	-4,352.71	-10,971.63	0.39	0.46	-1,071.98
3	-36,219.02	25	7	18	28.00	1,278.37	2,993.44	-2,509.31	-7,806.29	0.51	0.20	-1,448.76
2	-41,080.73	25	7	18	28.00	757.24	1,439.48	-2,576.74	-9,455.49	0.29	0.11	-1,643.23
1	-21,140.11	25	4	21	16.00	858.88	1,311.50	-1,170.27	-4,400.45	0.73	0.14	-845.60

We see here some very bearish statistics over the 1-2 day period. There is rarely upside follow-through when fear dissipates that quickly during a downtrend.

But now let's consider times like the present where SPX is in an uptrend.

VXO closes down over 15%. SPX > 200ma.
Buy SPX 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	5,970.85	27	14	13	51.85	1,899.01	5,396.71	-1,585.80	-4,561.65	1.20	1.29	221.14
4	5,080.04	28	16	12	57.14	1,218.15	2,499.00	-1,200.86	-2,356.90	1.01	1.35	181.43
3	5,499.96	29	15	14	51.72	1,183.91	2,819.60	-875.62	-2,321.70	1.35	1.45	189.65
2	3,452.22	29	16	13	55.17	1,014.69	2,322.60	-983.30	-2,076.48	1.03	1.27	119.04
1	3,537.50	30	15	15	50.00	912.73	2,842.84	-676.90	-2,176.20	1.35	1.35	117.92

Here there is no hint of a short-term bearish inclination. In fact the setup has shown slight gains for each of the time periods measured. Of course this does not help us with predicting the direction for the next few days, but it is certainly a lesson worth keeping in mind for the future.

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



With no new studies being added to the Active List the green Aggregator Line remained 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 strongly above 0. The positive Differential Line reading means the SPX is very oversold versus recent expectations. So expectations are bullish and the SPX is strongly 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 remain long at the close.

Based on the current studies, expectations are slated to remain positive on Monday. Of course this could change if more bearish evidence emerges. The Differential Pivot will be 1,560.50 on Monday. This is 0.3% above Friday's close. So it won't take much of a rally on Monday to move the Differential Line back through 0, signaling the SPX has moved from short-term oversold to short-term overbought versus expectations.

I currently have a small amount of long exposure. I don't intend to add to it at this point. We are still short-term oversold. We still have liquidity on our side. The long-term trend is up. And the patterns in play (per the studies shown in recent days) are primarily pointing higher. So I will let my small long position ride for now.

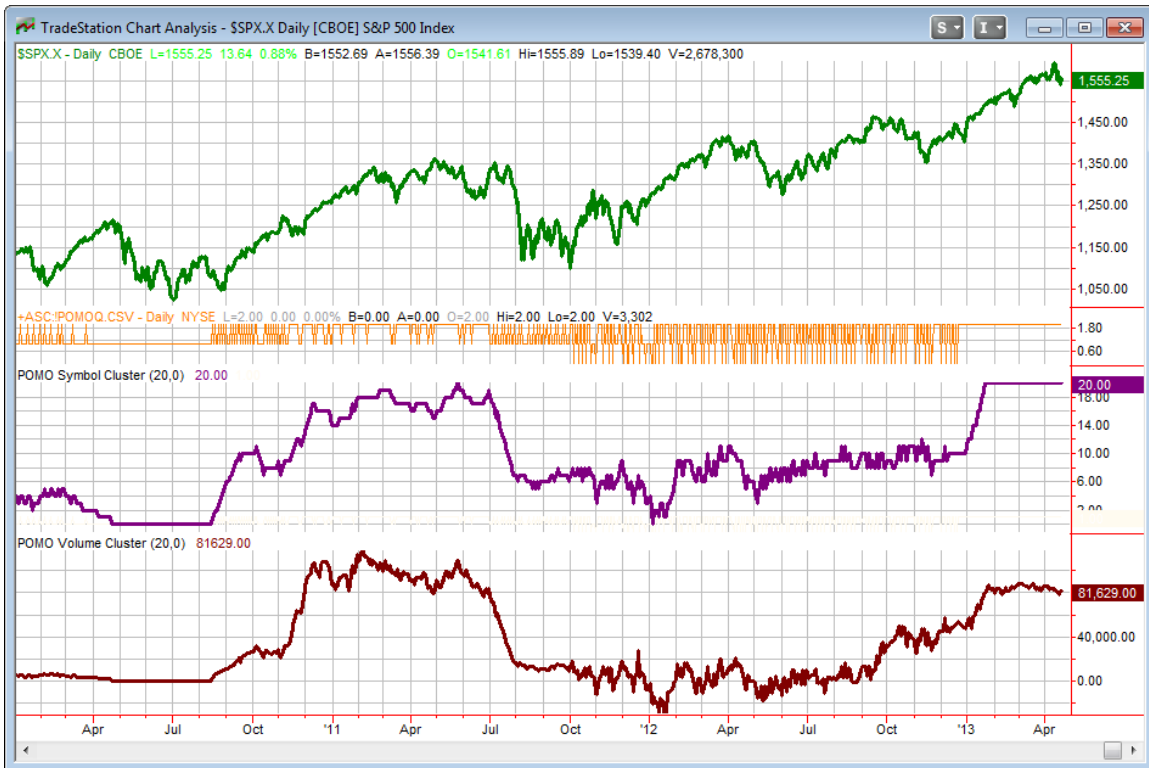
Intermediate-term Outlook (2 weeks – 2 months)– updated 4/22 – somewhat bullish

There was a lot of strong back and forth this week. And looking at a weekly chart there has been a fair amount of back and forth over the last several weeks. In fact, this is now the 5th week in a row that SPX has changed direction. So while the uptrend appears to be alive at this point, it does not have the same kind of momentum that it had up through mid-March. While we saw some compelling short-term edges emerge, nothing jumped out as far as the intermediate-term.

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 reflect 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.



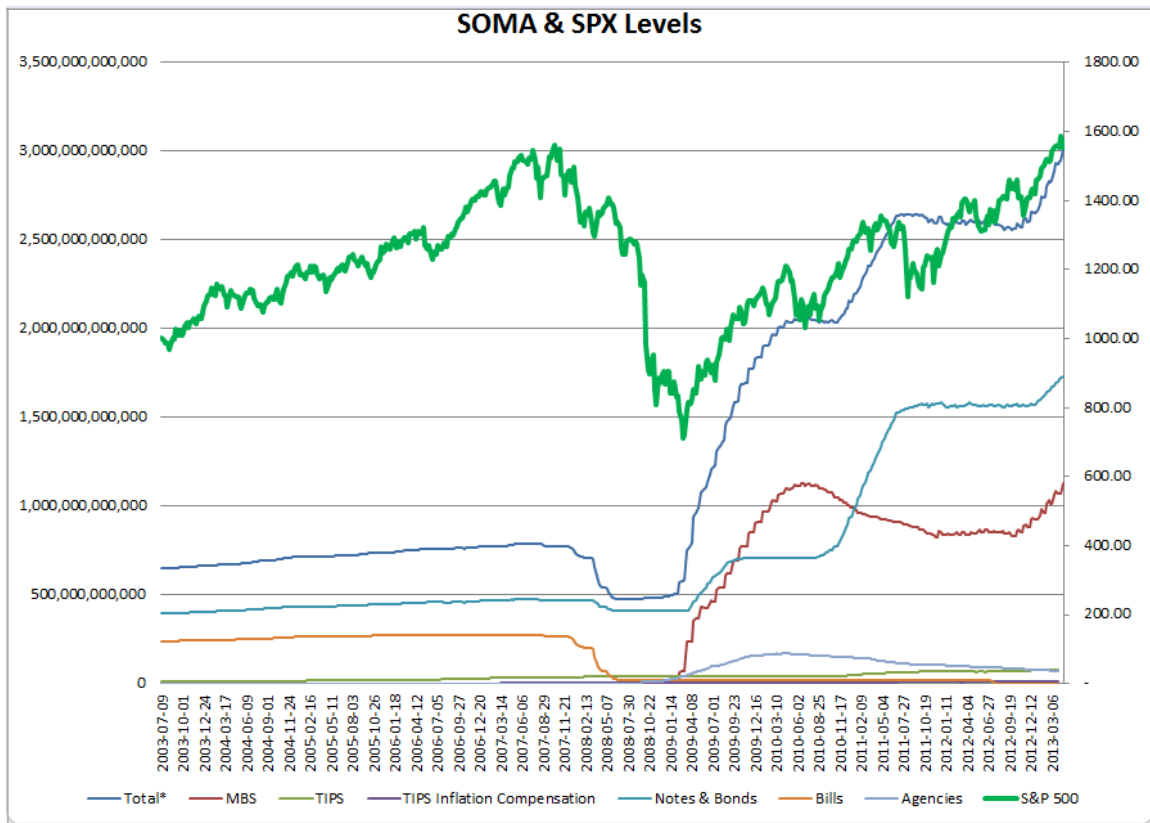
The POMO/AMBS volume indicator remained elevated in its 2013 range again this week, though it is now near the low end of that range. The days indicator is *still* maxed out at 20, which was a rarity during past QE implementations, but has been the norm so far this year. We estimate net inflows this past week to have been about \$21 billion, which is a strong number, especially during April. Inflows of this magnitude have typically provided short-term ammo for the bulls.

This upcoming week we expect to see liquidity flows a bit lighter. Between POMO and AMBS we should see about a \$18 billion inflow. That is still sizable, but compared to most of 2013, it is on the low side.

Below is an updated SOMA chart. SOMA is the account where the Fed holds all of the securities it purchases in the open market. A more detailed definition is provided by the Fed:

The System Open Market Account (SOMA), managed by the Federal Reserve Bank of New York, contains dollar-denominated assets acquired via open market operations. These securities serve three purposes:

- Collateral for U.S. currency in circulation and other reserve factors that show up as liabilities on the Federal Reserve System's balance sheet
- A tool for the Fed's management of reserve balances
- A store of liquidity in the event an emergency need for liquidity arises



It is a little tough to see all the way over on the right hand side of the chart, but the total value of the SOMA crossed over \$3 trillion this past week for the 1st time. That is an incredible increase from less than \$0.5 trillion prior to QE1. It also deserves much of the credit for the massive increase in the market during these periods of pumping.

Overall, intermediate-term evidence is still mixed. I have kept my outlook at “somewhat bullish” again this week. On the negative side we are still cognizant of the breadth divergence from the Study of Tops. The trend is still up, but price action has failed to generate any new bullish intermediate-term studies in recent weeks, and momentum has waned some. And while liquidity flows are positive, they are weaker than they have been

in a few months. The bears may be taking advantage of the relatively lighter liquidity flows and causing the rally to stumble. But as long as the current Fed policy remains in place, I don't foresee a strong correction occurring. I shall remain more aggressive on the long side than the short 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.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	4/15/2013	\$155.12	\$155.48	0.23%		Aggregator

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