

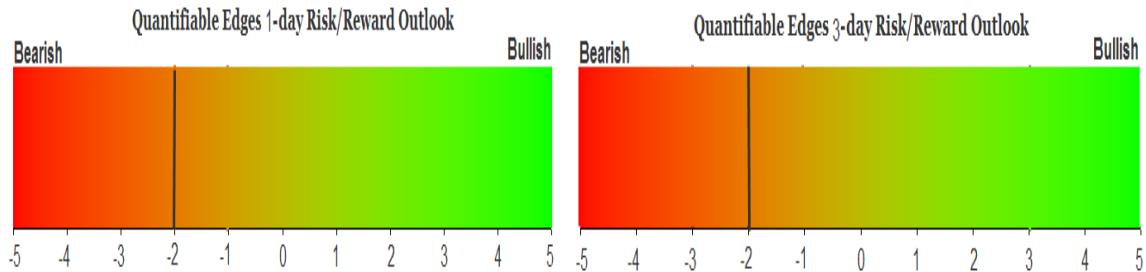
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 22, 2013

Volume 6 Issue 98

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Short	100% Short SPY	Flat	Flat

Tonight's Research Points

- The strong move up in the VIX on a day the SPX closes at a 50-day high suggests a short-term downside edge.
- High-volume outside days that close at a 50-day high also often lead to selling.

Short-term Outlook

The Bottom Line

No real change. The market remains squarely overbought. Short-term evidence points lower, but intermediate-term studies and liquidity are so strong that I am not interested in shorting. Wait and see for me.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
May 22, 2013	Outside day 50-high	1-2 days	Bearish	
May 22, 2013	VIX up strong at SPX 50-high.	1-2 days	Bearish	
May 21, 2013	SPX dn. Up Issue% > 55%.	1-2 days	Bullish	
May 17, 2013	SPX up 1%-2% opex week	1-5 days	Bearish	-1.40%
Active - Long Term				
May 10, 2013	5 days up to 50-high, then 1 down	1-10 days	Bullish	2.00%
May 9, 2013	Breadth Confirms Rally (Study of Tops)	int term	Bullish	
May 6, 2013	Nasdaq leading SPX	int term	Bullish	
April 29, 2013	Sell in May unless Jan-April strong	1-6 months	Bullish	6.80%
April 29, 2013	6 months higher in a row	1-10 months	Bullish	14.30%
September 17, 2012	QE3	int term	Bullish	
February 1, 2012	Golden Cross	int term	Bullish	
Dropped Tonight				
May 17, 2013	SPY > 5ma for 10 days. 10-high	1-2 days	Bearish	

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

The Evidence

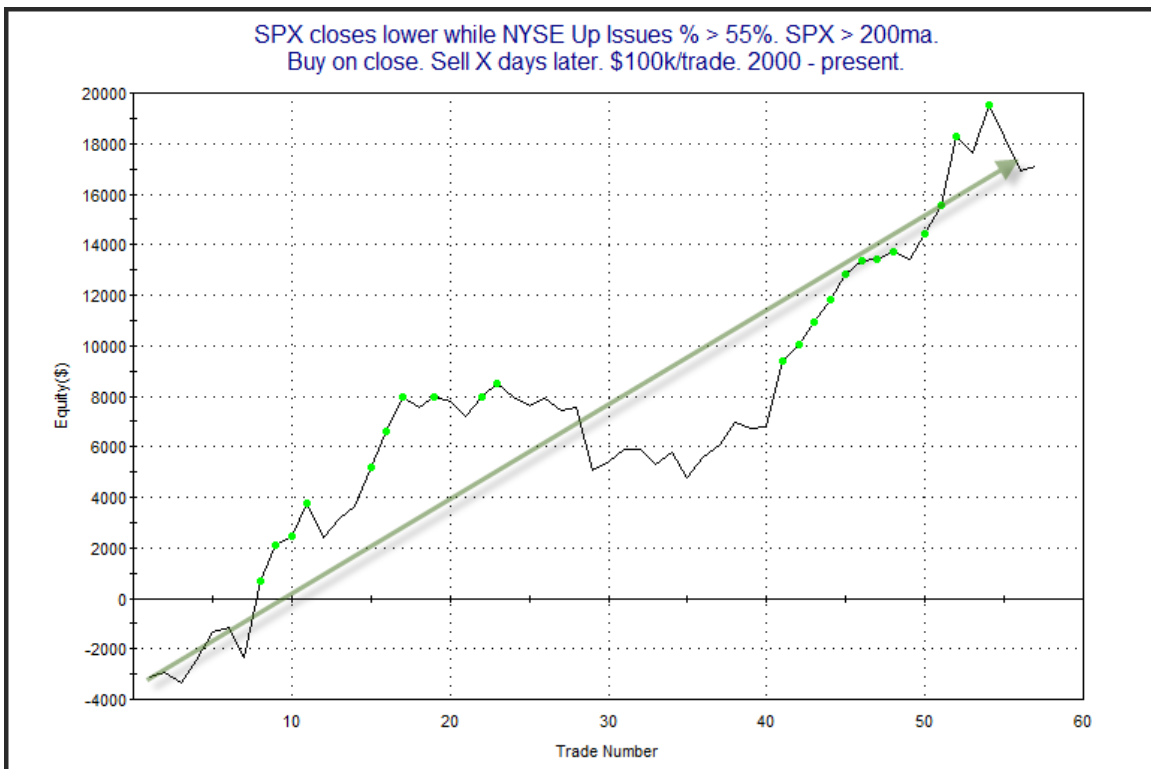
Tuesday the market crept higher once again. The SPX and NASDAQ each closed up 0.2% while the Russell 2000 rose 0.1%. Breadth was moderately positive as the NYSE Up Issues % was 54% and the Up Volume % was also 54%. Total NYSE volume was rose from Monday's level.

Before I get into tonight's studies, a word about Monday's action. I noted yesterday that SPX closed up 0.17 points. It appears that was a data error, and that the SPX actually closed down about 1 point. The data error was due to an adjustment that was made after the close on Friday. So the study I cited last night would not have in fact triggered had SPX been shown as closing down. Instead, it would have been the study below, which was last seen in the 10/8/12 Letter. It looked at strong breadth on the day that SPX closes down. I considered sending an update earlier today when I realized this, but while it would have changed Aggregator values slightly, it would not have changed the outlook. So I simply saved the correction for tonight.

SPX closes lower while NYSE Up Issues % > 55%. SPX > 200ma.
Buy on close. Sell X days later. \$100k/trade. 2000 - 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	17,908.36	52	32	20	61.54	1,374.74	3,616.92	-1,304.17	-4,012.80	1.05	1.69	344.39
4	19,072.02	54	33	21	61.11	1,308.72	3,429.00	-1,148.36	-2,921.28	1.14	1.79	353.19
3	18,102.79	56	37	19	66.07	1,012.83	3,373.50	-1,019.57	-2,852.01	0.99	1.93	323.26
2	17,119.35	57	39	18	68.42	861.12	3,025.12	-914.69	-3,119.03	0.94	2.04	300.34
1	14,427.91	59	35	24	59.32	719.39	2,484.00	-447.95	-1,348.29	1.61	2.34	244.54

The edge isn't huge, but it does appear to be high-percentage. The equity curve below gives a better idea of how the edge has played out over time.



While the curve certainly appears choppy, it seems good enough to give some consideration. I've again included it among the active studies.

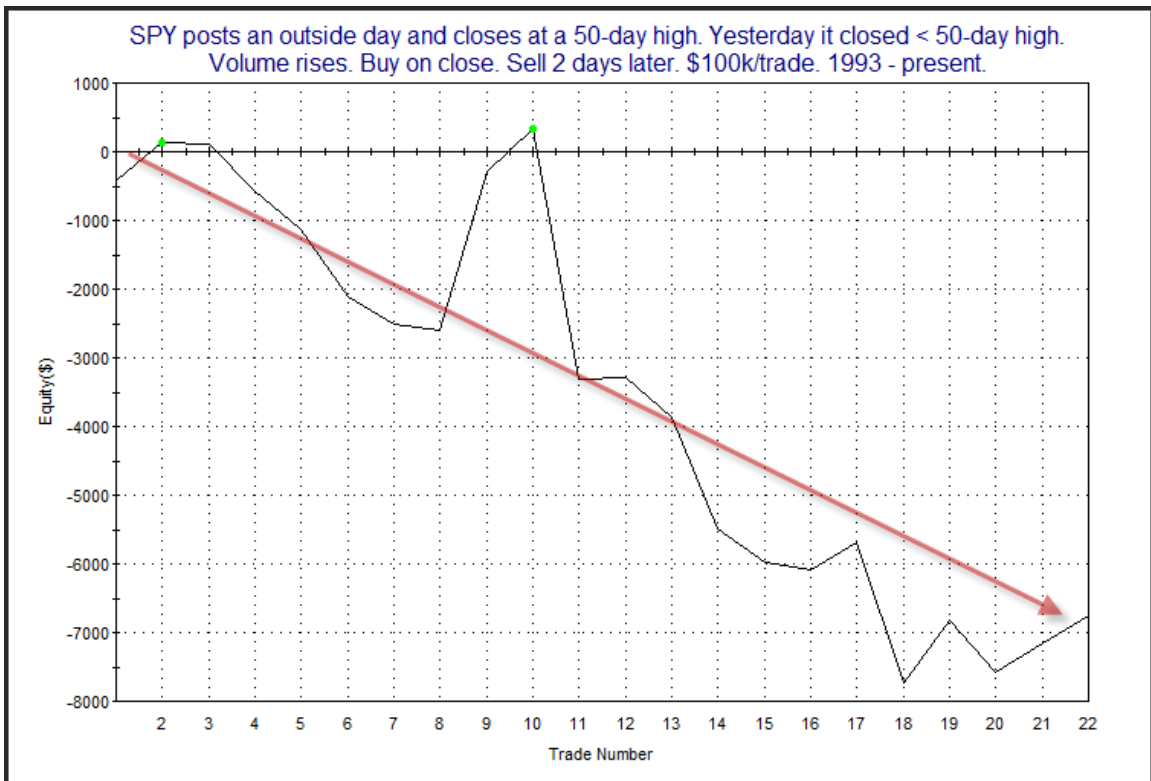
Now on to today.

This next study was from the 2/8/12 subscriber letter. It takes into consideration a number of observations that many would consider bullish. This includes an outside day and a 50-day high on rising volume. All stats are updated.

SPY posts an outside day and closes at a 50-day high. Yesterday it closed < 50-day high. Volume rises. 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	-11,152.65	22	12	10	54.55	947.04	2,590.50	-2,251.71	-4,473.36	0.42	0.50	-506.94
4	-5,169.14	22	12	10	54.55	1,048.41	2,371.65	-1,775.00	-4,518.34	0.59	0.71	-234.96
3	-7,653.26	22	10	12	45.45	1,130.83	2,927.90	-1,580.13	-5,133.72	0.72	0.60	-347.88
2	-6,758.85	22	8	14	36.36	703.70	2,324.90	-884.89	-3,640.86	0.80	0.45	-307.22
1	-4,609.35	22	10	12	45.45	436.25	918.96	-747.65	-2,448.72	0.58	0.49	-209.52

Rather than combining for a bullish edge it appears the scenario above has often been followed by brief downside. The most consistently bearish results occurred in the 2-day timeframe. Below is a profit curve for a 2-day exit strategy.

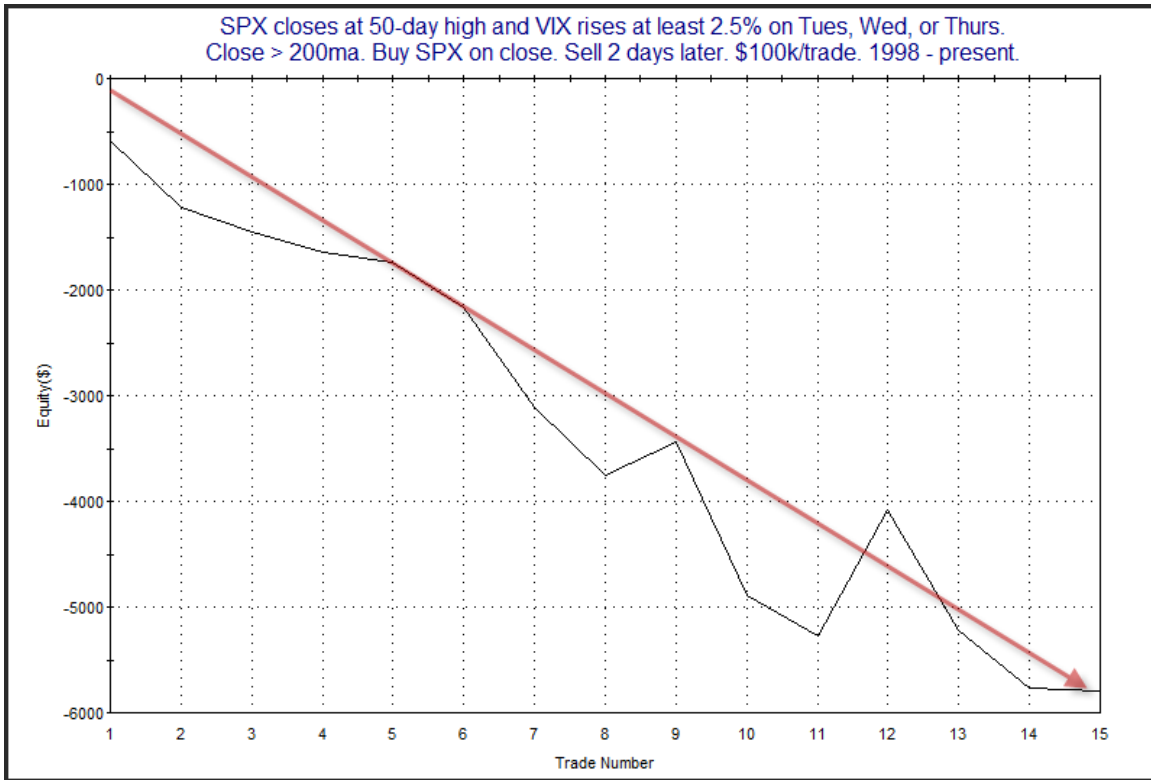


Choppy but downward sloping, this study also seems worth consideration.

There were some studies related to VIX action that appeared in the Quantifinder tonight. The one below was the most compelling. It last appeared in the 2/9/12 letter. New readers may wonder why I use a day-of-week filter with this study. The VIX has a natural tendency to fall on Fridays and rise on Mondays. Because of this I typically separate out those days from the rest of the week when conducting VIX-based studies. This particular study looks at large mid-week rises in the VIX during times the SPX is closing at a 50-day high. All results are updated.

SPX closes at 50-day high and VIX rises at least 2.5% on Tues, Wed, or Thurs. Close > 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1998 - 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	-5,904.21	15	6	9	40.00	870.34	2,108.40	-1,236.25	-4,149.36	0.70	0.47	-393.61
4	-9,759.63	15	4	11	26.67	737.63	1,629.60	-1,155.47	-4,240.48	0.64	0.23	-650.64
3	-8,294.80	15	6	9	40.00	567.35	1,271.55	-1,299.88	-4,423.40	0.44	0.29	-552.99
2	-5,796.06	15	2	13	13.33	757.10	1,192.71	-562.33	-1,461.48	1.35	0.21	-386.40
1	-1,428.71	18	10	8	55.56	257.99	1,108.05	-501.08	-1,008.70	0.51	0.64	-79.37
100% of instances closed below the entry price at some point in the next 4 days.												

Instances are a bit low, but the numbers are quite lopsided. Below is a profit curve assuming a 2-day exit strategy. (The 2-day was the most consistent and appealing.)



I see nothing here that would cause me to doubt the downside edge.

But not only did the VIX rise on Tuesday, it made a new short-term high. That is very unusual to see the VIX making a short-term high while SPX is making a long-term high. Over the last 15 years, that has also been a sign of possible trouble.

SPX closes at 50-day high while VIX closes at 10-day high.
Buy on close. Sell X days later. \$100k/trade. 1998 - 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	-8,311.54	9	4	5	44.44	1,102.45	2,323.00	-2,544.27	-4,221.70	0.43	0.35	-923.50
4	-10,828.80	9	2	7	22.22	1,116.15	1,262.70	-1,865.87	-4,240.48	0.60	0.17	-1,203.20
3	-9,553.58	9	2	7	22.22	1,335.27	1,539.24	-1,746.30	-4,423.40	0.76	0.22	-1,061.51
2	-2,880.41	9	2	7	22.22	1,165.11	1,835.17	-744.38	-1,461.48	1.57	0.45	-320.05
1	361.83	10	4	6	40.00	590.91	1,530.15	-333.63	-987.24	1.77	1.18	36.18

Instances are low, but the numbers appear to favor the bulls over the next 2-4 days. Below is a look at all the instances with a 4-day exit strategy.

SPX closes at 50-day high while VIX closes at 10-day high.
Buy on close. Sell 4 days later. \$100k/trade. 1998 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
03/25/98	Buy	\$1,102.00	(0.02%)	\$731.70
03/31/98	Sell	\$1,101.76		(\$1,078.20)
12/30/99	Buy	\$1,464.47	(4.26%)	\$920.04
01/05/00	Sell	\$1,402.11		(\$5,901.72)
12/30/03	Buy	\$1,109.64	1.26%	\$1,333.80
01/06/04	Sell	\$1,123.67		(\$410.40)
12/30/04	Buy	\$1,213.55	(2.46%)	\$356.70
01/05/05	Sell	\$1,183.72		(\$2,446.06)
09/05/06	Buy	\$1,313.25	(1.04%)	\$0.00
09/11/06	Sell	\$1,299.54		(\$1,696.32)
04/25/07	Buy	\$1,495.42	(0.61%)	\$171.60
05/01/07	Sell	\$1,486.30		(\$1,235.52)
07/31/09	Buy	\$987.48	0.97%	\$2,066.46
08/06/09	Sell	\$997.08		\$0.00
02/16/11	Buy	\$1,336.32	(2.16%)	\$573.50
02/23/11	Sell	\$1,307.40		(\$2,720.98)
04/02/12	Buy	\$1,418.90	(2.59%)	\$7.00
04/09/12	Sell	\$1,382.20		(\$2,846.20)
Avg Run-up: \$684 Avg Drawdown: -\$2037				

While instances are low, this in conjunction with the previous study, seems to offer confirmation that the rising VIX is providing a downside edge.

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



Tonight's studies helped push the green Aggregator Line further below zero. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line remained well below 0. The negative Differential Line reading means the SPX is overbought versus recent expectations. So expectations are negative and the SPX is still overbought. This is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close below 0. This caused the Aggregator system to remain short at the close.

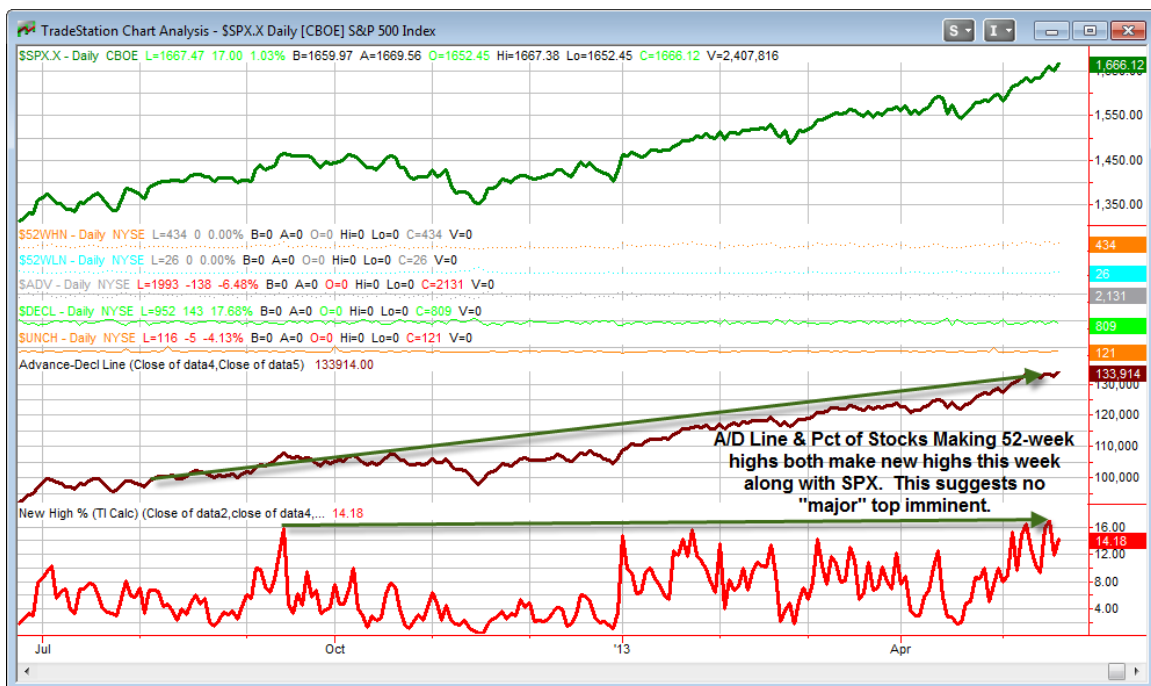
Based on the current studies, expectations are slated to remain negative on Wednesday. Of course this could change if new bullish evidence emerges. The Differential Pivot will be 1664.43 on Wednesday. This is about 0.3% below Tuesday's close. So SPX will need to close down at least this much in order for it to move from overbought to oversold versus expectations.

My stance has not changed. The market is strongly overbought and there is evidence that we should see a pullback in the next few days. But shorting has been extremely difficult in this environment, thanks largely to the massive liquidity infusion from the Fed. So I have not been inclined to short since the turn of the year, and I likely won't until Fed policy changes. I remain in "wait & see" mode.

Intermediate-term Outlook (2 weeks – 2 months)– updated 5/20 –bullish

The market put in another strong week, and is *again* at new highs, erasing any doubt of an uptrend. The persistent move higher has been impressive. And while no new intermediate-term studies emerged this week, the open ones continue to all favor a further rally.

One very positive sign was that a couple of breadth indicators we track again made new highs this week. Those were the NYSE Advance/Decline Line, and the percent of stocks hitting new 52-week highs. In the Quantifiable Edges Study of Tops (always available on the Downloads page for subscribers) I went through every major top since 1970. For purposes of that study I defined a “major top” as any top that was followed by a decline of at least 20%. I found that in every case, there was a divergence in % of NYSE issues hitting new 52 week highs, and that the divergence was in effect for at least 2 months before any market top. Here is an updated chart with that indicator.

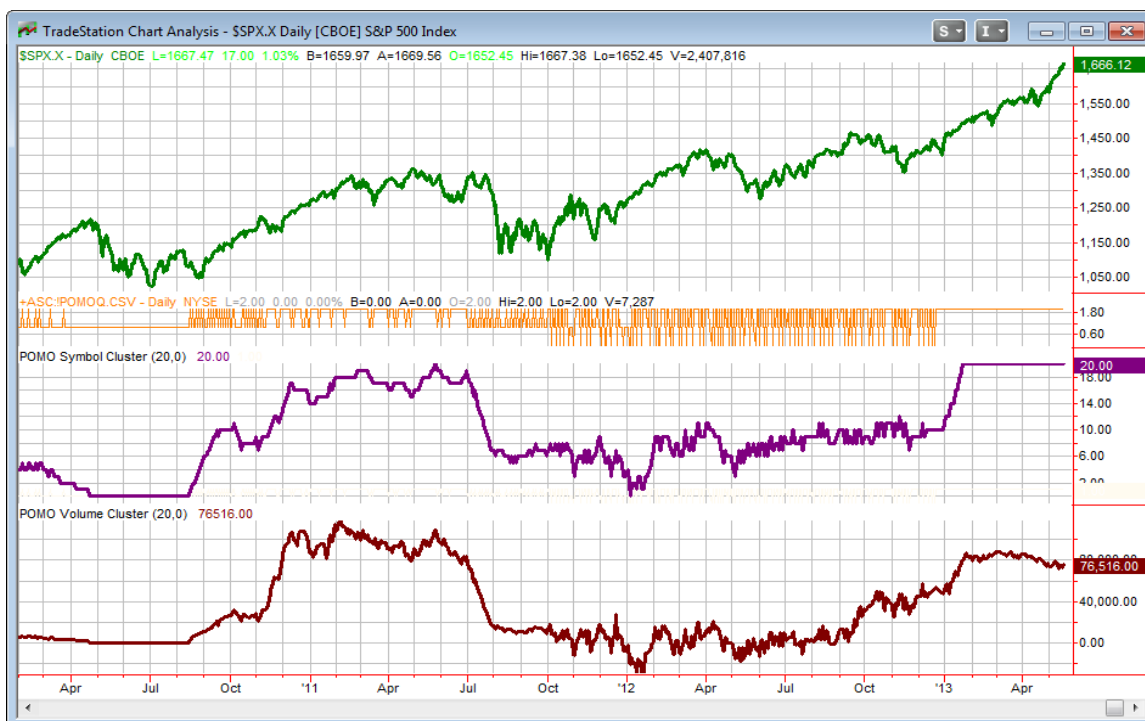


While the market is always capable of doing something new, Wednesday’s high readings appear to greatly reduce the risk of a bear market beginning in the next 2 months. For a view of all tops since 1970, please refer to the Study of Tops. Here is a link for your convenience.

[QEStudyOfTops.pdf](#)

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 curled back up a little this week. 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 \$20.2 billion, which is an impressive amount. In the past, inflows of this magnitude have typically been bullish looking out over the next several days.

This upcoming week we expect to see liquidity flows of about \$18.6 billion. While lower, this should continue to keep the liquidity environment positive.

Bullish studies continue to dominate the intermediate-term. The leading Nasdaq, the “6 up months” study and the “Sell in May unless there hasn’t been a 5% pullback” studies all listed among the Active Studies at the top of this letter all support the bullish case. And of course, the factor I consider to be most important is liquidity flows. The Fed pump is still on. And as long as the Fed is pumping strongly it does not seem advisable to bet against the market. So my intermediate-term outlook remains bullish again this week. From a trading standpoint that generally means I will be more aggressive from the long side, and very conservative about shorting.

Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

Open Catapult Triggers

EXC- bought 1/3 @ \$35.25 limit

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 1(EXC)

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
EXC(1/3)	5/7/2013	\$35.25	\$35.01	-0.68%	\$34.60	Catapult

I have placed a stop just beneath the low of the recent consolidation on a daily chart. If it breaks that level we could see another leg down. And that is something I would like to avoid.

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