

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 23, 2013

Volume 6 Issue 99

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- Tuesday's multi-day engulfing down suggests a bounce.
- Strong drops from 50-day highs have consistently been followed by bounces.

## *Short-term Outlook*

### *The Bottom Line*

A sharp drop saw expectations turn positive and the market turn oversold. It is only 1 day down so far, but if we get another one tomorrow I'll likely be getting long at the close.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
May 23, 2013	Big drop from 50-day high	1-4 days	Bullish	1.20%
May 23, 2013	3-hi. 3-low. 3-low close. Close > 200.	1-5 days	Bullish	2.10%
May 23, 2013	Double Outside Day	1-5 days	Bullish	1.90%
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%
<b>Active - Long Term</b>				
May 23, 2013	3-hi. 3-low. 3-low close. Close > 200.	1-15 days	Bullish	4.10%
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	
<b>Dropped Tonight</b>				
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	

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

***The Evidence***

A strong start to the day was followed by a strong reversal and the major averages plunged lower. SPX lost 0.8%, the Nasdaq fell 1.1% and the Russell 2000 declined 0.7%. Breadth was strongly negative as the NYSE Up Issues % was 22% and the Up Volume % was 23%. Total NYSE volume rose for the 2<sup>nd</sup> day in a row.

A good number of studies triggered tonight that examined different characteristics of the reversal. I selected the most compelling ones to discuss tonight.

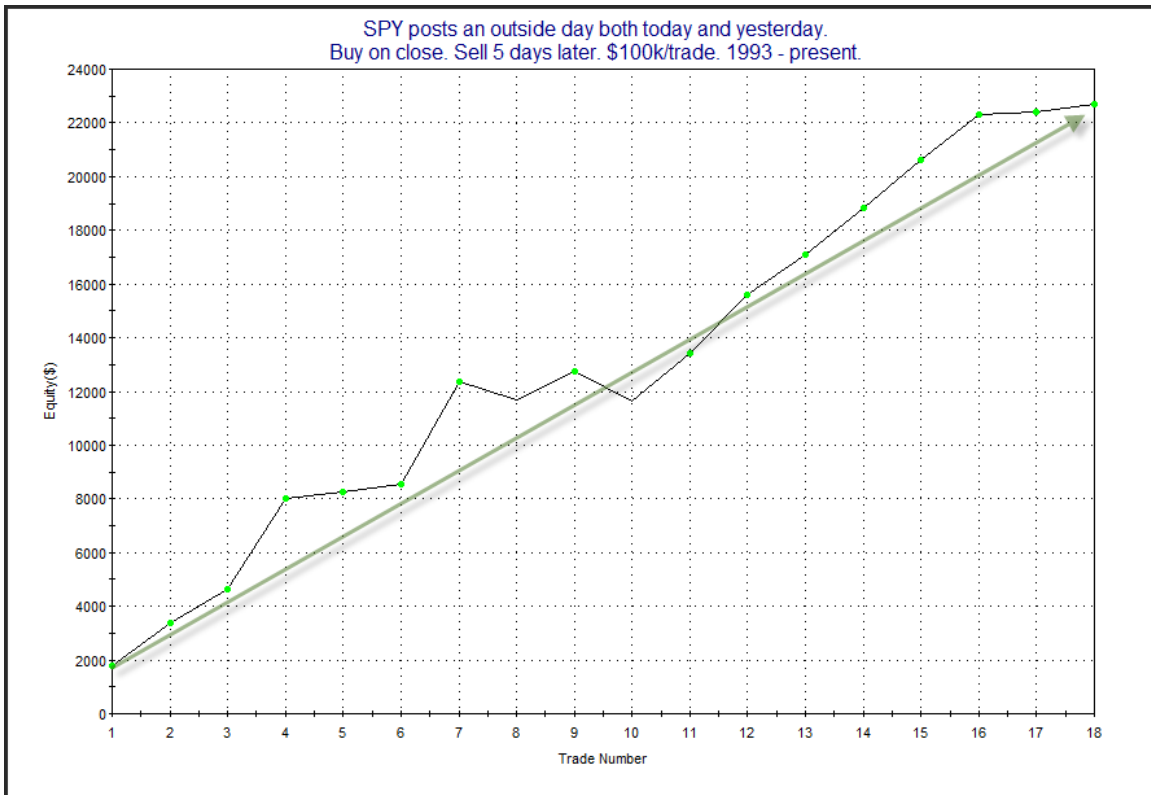
Wednesday marked the 2nd day in a row that SPY posted an outside day. (An outside day is a day where the security or index makes a higher high and a lower low than the day before.) I last discussed back-to-back outside days in the 10/26/12 letter. I have updated those results below.

SPY posts an outside day both today and yesterday.  
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	22,680.36	18	16	2	88.89	1,527.94	3,826.52	-883.32	-1,080.30	1.73	13.84	1,260.02
4	18,632.27	18	16	2	88.89	1,281.93	2,617.44	-939.33	-1,545.66	1.36	10.92	1,035.13
3	17,299.49	18	13	5	72.22	1,566.73	3,447.12	-613.61	-1,404.39	2.55	6.64	961.08
2	7,910.31	18	11	7	61.11	1,107.05	1,779.33	-609.60	-1,902.99	1.82	2.85	439.46
1	5,256.23	18	11	7	61.11	764.11	1,585.08	-449.85	-1,221.57	1.70	2.67	292.01

The only instance not to post a higher close at some point in the next week triggered on 1/3/05. It also made a long-term intraday high on that day.

The numbers look very impressive. Below is a profit curve using a 5-day holding period.



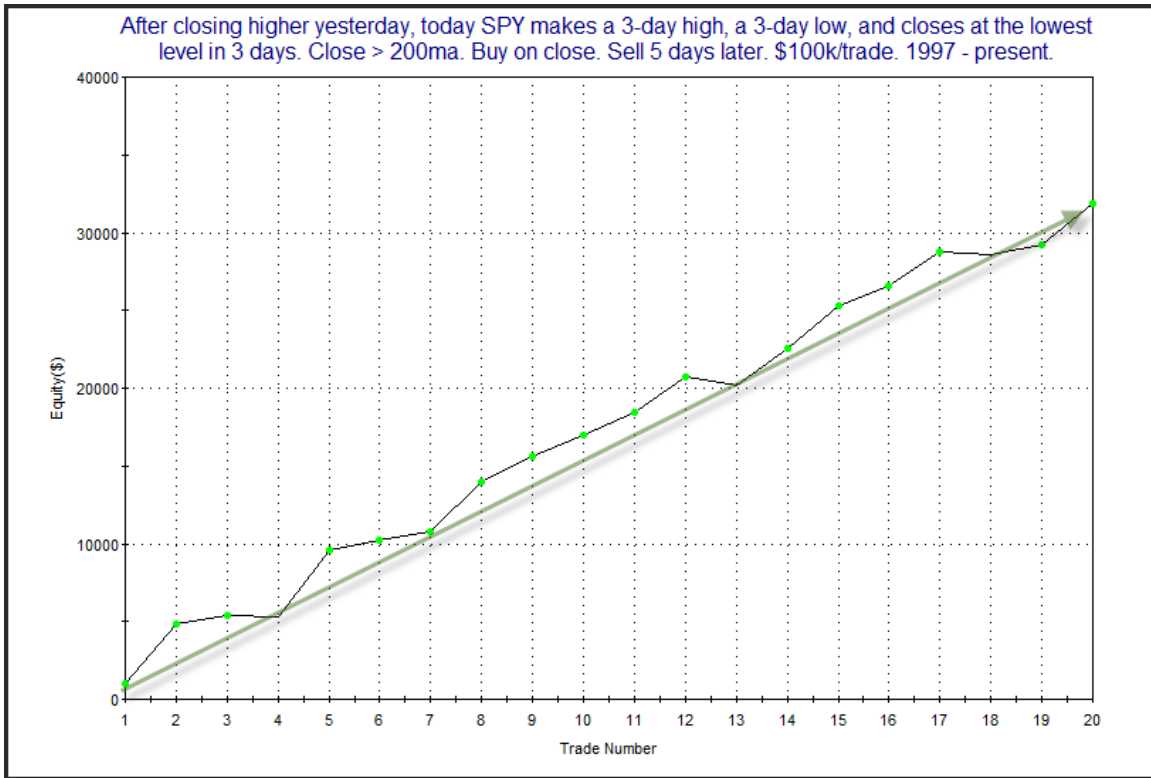
The steady upslope of the profit curve is impressive and encouraging for the bullish case.

When price makes a new high as it did Wednesday, and then reverses down to form an outside day and closes negative that is considered a "key reversal". I looked at reversals like this in number of times in the past. For the very short-term there rarely appears to be a substantial edge. Often test results will show churn or very mildly bearish numbers. But when you look out 1 to 2 weeks what you often see is that the uptrend most of the time will reassert itself.

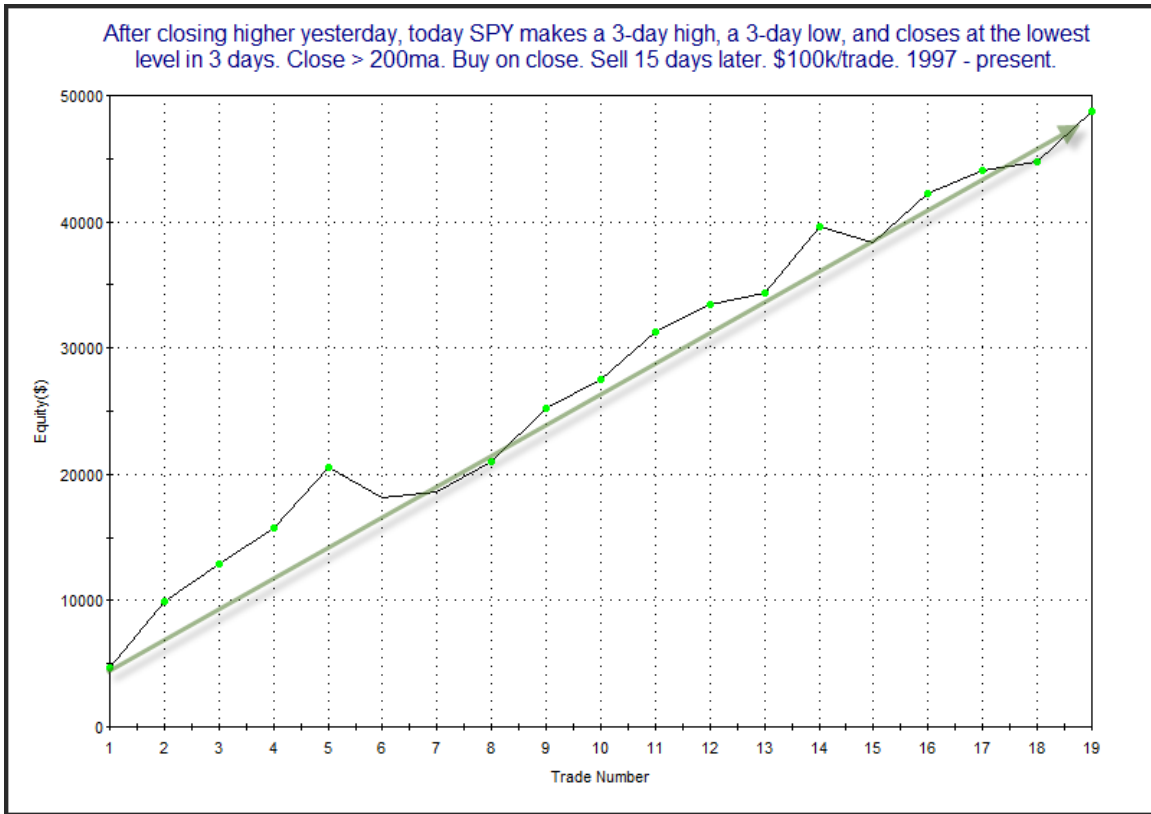
The study below was last shown in the 8/22/12 subscriber letter. It looks for the reversal day to engulf both of the last two days, close at a three day low, and still be above the 200ma. All results are updated.

After closing higher yesterday, today SPY makes a 3-day high, a 3-day low, and closes at the lowest level in 3 days. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1997 - 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
15	48,760.02	19	17	2	89.47	3,083.28	5,325.42	-1,827.91	-2,404.50	1.69	14.34	2,566.32
14	45,723.92	19	17	2	89.47	2,949.15	5,803.82	-2,205.83	-3,503.70	1.34	11.36	2,406.52
13	39,530.52	19	15	4	78.95	3,012.18	5,600.32	-1,413.03	-2,418.71	2.13	7.99	2,080.55
12	41,121.98	19	16	3	84.21	2,829.81	7,684.16	-1,384.97	-2,350.04	2.04	10.90	2,164.31
11	40,668.37	19	17	2	89.47	2,711.17	5,982.90	-2,710.78	-3,624.25	1.00	8.50	2,140.44
10	38,989.65	19	15	4	78.95	2,834.35	6,438.74	-881.38	-1,808.31	3.22	12.06	2,052.09
9	38,407.96	20	16	4	80.00	2,697.84	6,845.74	-1,189.39	-3,430.00	2.27	9.07	1,920.40
8	29,667.78	20	14	5	70.00	2,749.77	5,456.88	-1,765.79	-7,031.50	1.56	4.36	1,483.39
7	34,613.45	20	14	6	70.00	2,904.99	6,365.48	-1,009.40	-1,635.06	2.88	6.72	1,730.67
6	35,681.90	20	16	4	80.00	2,336.41	5,193.32	-425.18	-645.78	5.50	21.98	1,784.09
5	31,898.86	20	17	3	85.00	1,926.43	4,273.50	-283.49	-489.14	6.80	38.51	1,594.94
4	18,740.27	20	14	6	70.00	1,725.02	4,533.98	-901.67	-2,123.52	1.91	4.46	937.01
3	5,161.64	20	12	8	60.00	1,720.43	3,903.34	-1,935.44	-5,283.03	0.89	1.33	258.08
2	4,578.54	20	12	8	60.00	1,436.30	3,244.78	-1,582.13	-3,737.28	0.91	1.36	228.93
1	414.76	20	13	7	65.00	625.69	2,359.84	-1,102.74	-3,909.03	0.57	1.05	20.74

After the first three days or so, there appears to be a strong and consistent upside edge. And it appears to last for a few weeks. Below is a profit curve that assumes a 5-day holding period.



Equity curves don't get much straighter than this...but it could be rivaled by the 15-day holding period curve.



These curves appear to be nice confirmation of the bullish suggestion by the stats table.

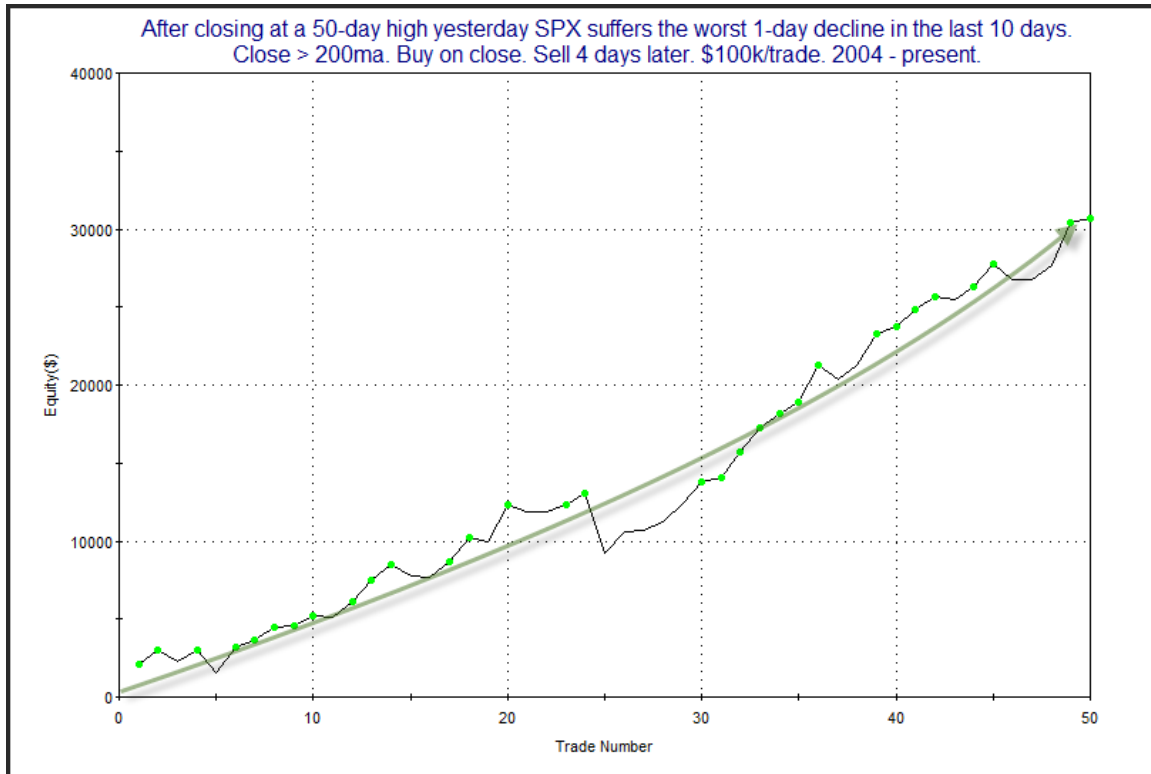
The last study to review tonight is one that was just seen a few days ago in the 5/17/13 letter. It considers such factors as Tuesday's 50-day high, Wednesday's relatively large drop, and the long-term trend. I have updated all the stats.

After closing at a 50-day high yesterday SPX suffers the worst 1-day decline in the last 10 days. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 2004 - 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	26,507.79	46	32	14	69.57	1,404.88	3,149.37	-1,317.74	-3,454.00	1.07	2.44	576.26
4	30,723.22	50	37	13	74.00	1,096.57	2,725.38	-757.68	-3,895.76	1.45	4.12	614.46
3	20,163.09	51	36	15	70.59	864.01	2,192.40	-729.41	-1,808.21	1.18	2.84	395.35
2	12,558.86	52	31	21	59.62	806.12	2,437.50	-591.95	-1,777.55	1.36	2.01	241.52
1	5,337.47	52	31	21	59.62	534.23	1,249.60	-534.46	-1,354.59	1.00	1.48	102.64

**48 of 52 instances (92%) closed above the entry price at some point in the next 5 days.**

Over the last 9 years the stats are impressive. And the 3-4 day consistency is strong. Below is a profit curve that assumes a 4-day holding period.



The steady upslope seems to confirm the bullish inclination. I've included this study on the active list.

There were also a few studies that looked at large reversal from intermediate to long-term highs. I examined these and looked at Wednesday's big drop from the intermediate-term high a few different ways. Overall, results were inconsistent and somewhat conflicting, so I elected to simply ignore those studies for tonight.

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



Tonight's studies helped push the green Aggregator Line back above zero. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line also shot above 0. The positive Differential Line reading means the SPX is oversold versus recent expectations. So expectations are positive and the SPX is now 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 turn long at the close.

Based on the current studies, expectations are slated to remain positive on Thursday. Of course this could change if new bearish evidence emerges. The Differential Pivot will be 1665.85 on Thursday. This is about 0.6% above Wednesday's close. So SPX will need to close up at least this much in order for it to move from oversold to overbought versus expectations.

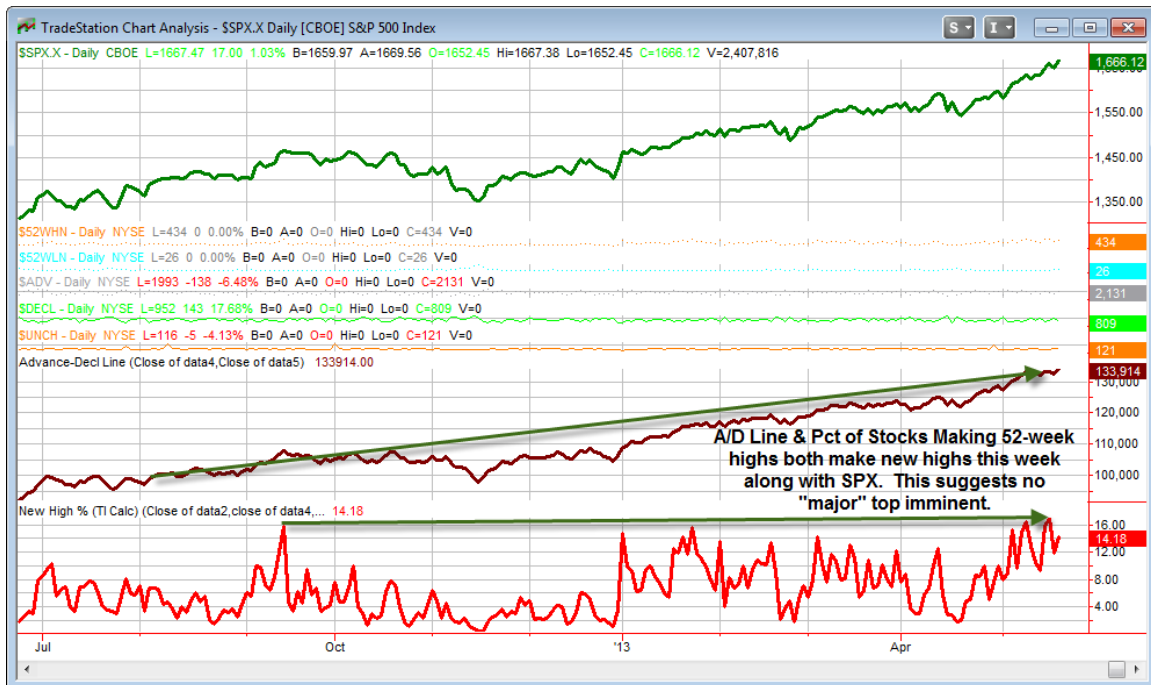
I've been waiting for a pullback and we finally may have one here. Though the Aggregator is already giving a long signal, I am not going to rush right in. I have noted in the last few days that SPX has not closed below its 10ma since 4/22. That is a long time without any substantial pullback. The selloff today, while fairly sizable, still did not get us down to the 10ma. But if we close below it tomorrow, I will be looking to start scaling into a position.

The issue that got credit for the reversal is Bernake's speech before congress. The market can get awful twitchy when the end of Quantitative Easing comes up. And I am of the belief that when it does end, we are likely to see some real struggles. Of course those struggles could begin as the market anticipates the end, rather than after it actually happens. But if we look back at QE2, though the market knew when that was ending well in advance, it did not begin its swoon until after QE2 was over. In that case the strong liquidity was still enough to prop up the market as long as the pumping was going on. That is not to say the selling won't begin earlier this time. It certainly could. As we get closer to the end of QE4 here, it will be important to watch for signs of a faltering market. Since 2005, every time the Fed has turned off the pump, the market has struggled. Of course, I am getting ahead of myself a little here. For now I am treating this as a buyable pullback.

***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.

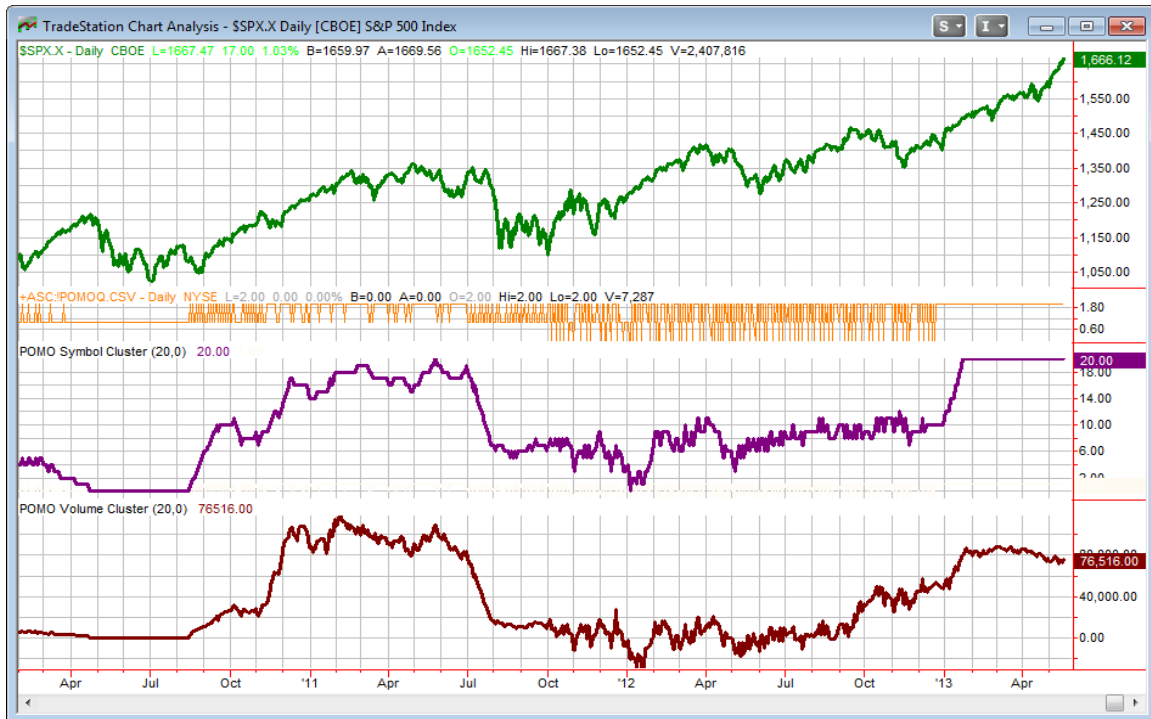


While the market is always capable of doing something new, Wednesday's high readings appear to greatly reduce the risk of a bear market beginning in the next 2 months. For a view of all tops since 1970, please refer to the Study of Tops. Here is a link for your convenience.

[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***

*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.*

***SPY – buy ¼ index position @ \$165.60 LIMIT ON CLOSE.** Based on the short-term outlook above, I will look to start scaling in long if SPY closes down a bit on Thursday.*

## **Current Open Trade Ideas**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Price</b>	<b>% Gain/Loss</b>	<b>Stop</b>	<b>Notes</b>
<i>EXC(1/3)</i>	<i>5/7/2013</i>	<i>\$35.25</i>	<i>\$34.89</i>	<i>-1.02%</i>		<i>stopped out intraday</i>

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