

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 24, 2013

Volume 6 Issue 120

Market Overview



Signals Overview

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

Tonight's Research Points

- The weak bounce on Friday is indicative of the kind of action that has often been followed by a pullback over the next few days.
- Short-term liquidity remains a positive.
- Seasonality *may* be a weakness this upcoming week.

Short-term Outlook

The Bottom Line

The studies are quite mixed, but the market remains extremely oversold. I have a small long position that I intend to maintain. I will see what studies emerge Monday and in the next few days before looking to exit or perhaps increase my position.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
June 24, 2013	Weak bounce	1-3 days	Bearish	
June 21, 2013	System 110524	1-7 days	Bullish	
June 21, 2013	1% drop. Bad breadt.	1-5 days	Bullish	
Active - Long Term				
June 4, 2013	Hindenburg Omen cluster	1-50 days	Bearish	-8.60%
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	

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

The Evidence

After registering strong oversold indications on Thursday, we saw several studies Thursday night suggesting a bounce on Friday. And that bounce came. But it was not very impressive. The SPX and Russell 2000 each gained 0.3%, but the Nasdaq finished down 0.2%. Breadth was about breakeven as the NYSE Up Issues % was just under 50% and the Up Volume % was 51%. Aided by options expiration, total NYSE came in at the highest level since September of 2011.

The first day of a bounce from an oversold condition can often provide strong hints about how the next several days are likely to perform. Weak bounces like we saw on Friday tend to have a much lower success rate over the following days. This is something I discussed in some detail in the 4/27/13 subscriber letter. The studies shown there are relevant in this case, so I'm going to review them again along with updated stats.

All of the studies looked at day-one bounces following a drop the previous day of at least 1.75%. I found that the "sweet spot" for such a bounce is one that makes up between 25% and 75% of the previous day's losses. That's strong enough to get the market moving, but not so strong that it exhausts the upside edge. Here is an updated stats table that looks at instances of this. (Note that the other tables go back to 1988, but this one goes back to 1961 because the edge has been so strong for so long with this one.)

SPX falls at least 1.75% yesterday. Today it makes up between 25% and 75% of yesterday's loss.
Close > 200ma. Buy 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
5	68,139.39	35	33	2	94.29	2,186.68	5,396.71	-2,010.49	-2,115.67	1.09	17.95	1,946.84
4	53,512.24	36	30	6	83.33	1,975.42	4,989.22	-958.41	-2,322.56	2.06	10.31	1,486.45
3	48,700.06	36	32	4	88.89	1,704.25	3,876.62	-1,459.02	-3,602.40	1.17	9.34	1,352.78
2	32,113.99	36	24	12	66.67	1,817.55	4,001.40	-958.93	-2,136.90	1.90	3.79	892.06
1	26,154.59	36	26	10	72.22	1,220.52	2,937.71	-557.90	-1,576.20	2.19	5.69	726.52

Every instance closed above the entry price at some point in the next week except for 3/11/11 (which was immediately met with a Japanese earthquake, followed by a tsunami, and then a nuclear disaster, so I'll forgive that one).

As you can see, there is a near-perfect record of continued follow-through in the next week.

This next table examines very strong bounces after big drops. Results here have not changed so they are not updated.

SPX falls at least 1.75% yesterday. Today it makes up more than 75% of yesterday's loss.
Close > 200ma. Buy 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: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	10,065.10	11	6	5	54.55	2,695.45	-1,221.52	2.21	2.65	915.01
9	18,347.76	12	7	5	58.33	3,222.39	-841.79	3.83	5.36	1,528.98
8	13,458.35	12	8	4	66.67	2,717.76	-2,070.94	1.31	2.62	1,121.53
7	20,267.80	13	7	6	53.85	3,881.73	-1,150.72	3.37	3.94	1,559.06
6	21,024.09	13	9	4	69.23	3,062.40	-1,634.39	1.87	4.22	1,617.24
5	20,983.30	13	9	4	69.23	2,686.85	-799.58	3.36	7.56	1,614.10
4	15,131.28	13	8	5	61.54	2,696.96	-1,288.88	2.09	3.35	1,163.94
3	11,326.45	13	7	6	53.85	2,398.77	-910.83	2.63	3.07	871.27
2	8,507.74	13	8	5	61.54	1,872.31	-1,294.15	1.45	2.31	654.44
1	993.58	13	6	7	46.15	1,473.27	-1,120.87	1.31	1.13	76.43

12 of 13 instances closed above the entry price at some point in the next week. All of them did so within 6 days.

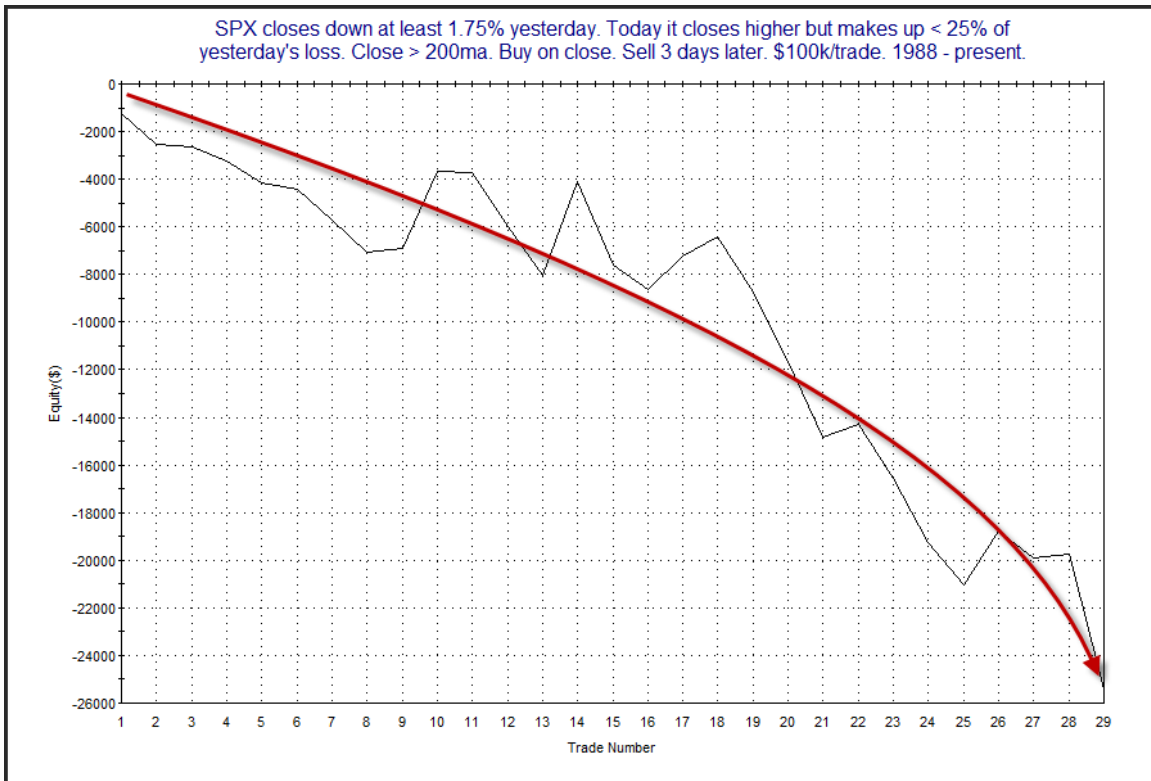
Instances are a bit low here but still show a decent upside inclination.

Of course as I noted above, Friday's bounce was weak. And it was so weak that it failed to make up 25% of Thursday's losses. So let's take a look and see how the market has fared following weak bounces.

SPX closes down at least 1.75% yesterday. Today it closes higher but makes up < 25% of yesterday's loss. Close > 200ma. Buy 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	-17,542.01	29	11	18	37.93	1,619.47	4,769.00	-1,964.23	-5,506.23	0.82	0.50	-604.90
4	-21,526.70	29	10	19	34.48	1,650.54	2,587.95	-2,001.69	-4,284.75	0.82	0.43	-742.30
3	-25,404.78	29	8	21	27.59	1,561.43	3,939.79	-1,804.58	-5,685.45	0.87	0.33	-876.03
2	-18,801.39	30	13	17	43.33	662.39	2,794.56	-1,612.50	-3,844.10	0.41	0.31	-626.71
1	-13,456.63	30	11	19	36.67	587.50	1,669.20	-1,048.38	-2,302.95	0.56	0.32	-448.55

Numbers here show a sharp contrast to the stats shown after strong bounces. The downside edge primarily appears to play itself out over the first three days. Below I have produced an equity curve that assumes a 3-day holding period.

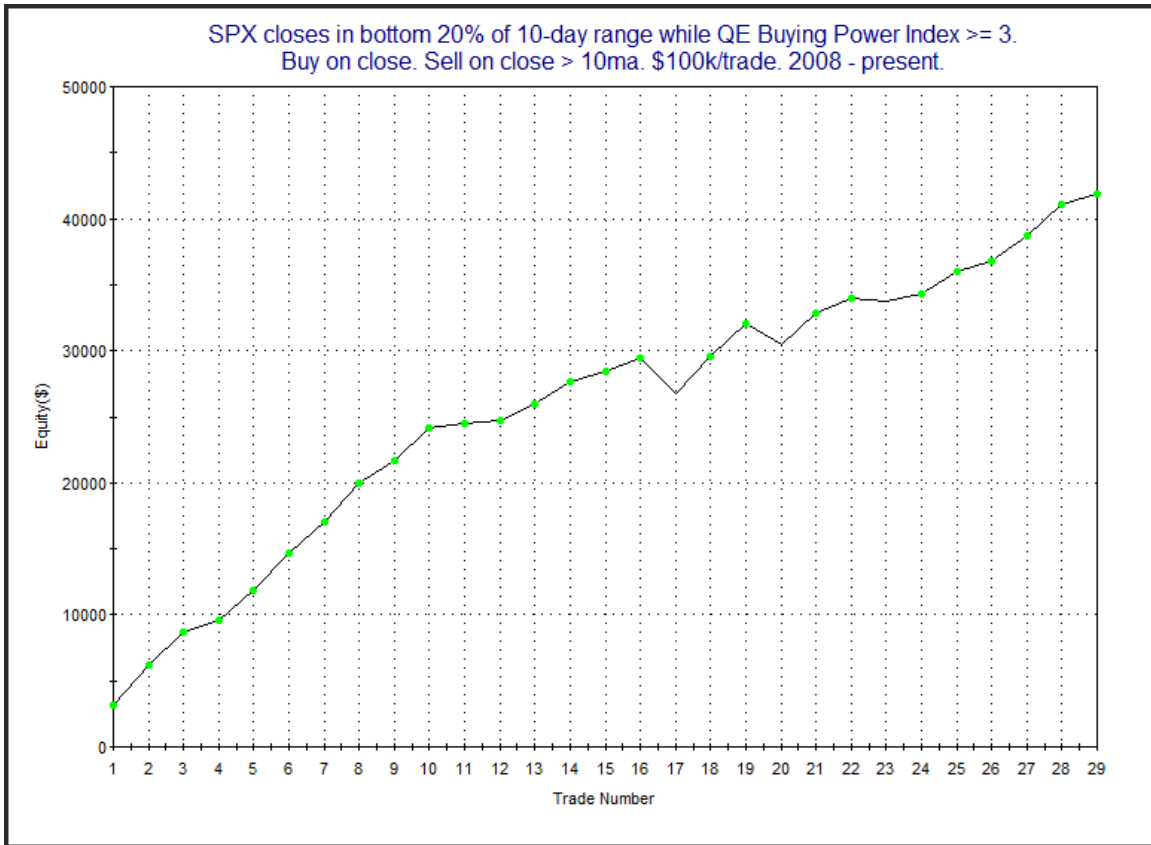


The equity curve shows that the downside edge has been prevalent for a long time, and in recent times it has been even stronger than usual. This study seems to be worth consideration and I have included it on the Short-Term Active List.

From a bullish standpoint, there was one thing I neglected to discuss on Thursday night which I thought I would bring it little attention to. That is the fact that the QE Buying Power System triggered a long signal. The system looks to go long whenever SPX closes in the lower end of its 10-day range and the QE Buying Power Index is at three or above. Below is a simple table showing how the market has performed since 2008 when QE Buying Power System longs have triggered if they were taken and then held until SPX closed back above its 10ma.

SPX closes in bottom 20% of 10-day range while QE Buying Power Index >= 3. Buy on close. Sell on close > 10ma. \$100k/trade. 2008 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$41,860.89	Profit Factor	9.91
Gross Profit	\$46,560.21	Gross Loss	(\$4,699.32)
Total Number of Trades	29	Percent Profitable	89.66%
Winning Trades	26	Losing Trades	3
Even Trades	0		
Avg. Trade Net Profit	\$1,443.48	Ratio Avg. Win:Avg. Loss	1.14
Avg. Winning Trade	\$1,790.78	Avg. Losing Trade	(\$1,566.44)
Largest Winning Trade	\$3,160.20	Largest Losing Trade	(\$2,750.44)

The numbers here are incredibly strong. They suggest that oversold conditions are unlikely to remain so when liquidity is very strong. Below is a profit curve showing how these gains would have been achieved.



That is about as good-looking a profit curve as you are ever going to see. I'll discuss liquidity a bit more in the intermediate-term section below. Much of what seemed to spark the selling this week was the fact that the Fed indicated time frames for possible tapering and then ending of its quantitative easing programs. While we anticipate the market will struggle as liquidity flows lessen, they are still strong and should serve to help the market, at least in the short-term.

It was pointed out to me that the week after June options expiration has done especially poorly in recent years. The table below shows all such weeks dating back to 1999.

Weekly SPX performance following opex Friday in June.
\$100k/trade. 1999 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
06/18/99	Buy	\$1,342.84	(2.05%)	\$612.72
06/25/99	Sell	\$1,315.31		(\$2,541.16)
06/16/00	Buy	\$1,464.48	(1.57%)	\$1,662.60
06/23/00	Sell	\$1,441.54		(\$1,779.56)
06/15/01	Buy	\$1,214.36	0.91%	\$2,122.16
06/22/01	Sell	\$1,225.42		(\$545.30)
06/21/02	Buy	\$989.14	0.07%	\$1,690.74
06/28/02	Sell	\$989.82		(\$3,658.22)
06/20/03	Buy	\$995.69	(1.96%)	\$0.00
06/27/03	Sell	\$976.22		(\$2,189.00)
06/18/04	Buy	\$1,135.02	(0.05%)	\$996.16
06/25/04	Sell	\$1,134.43		(\$937.20)
06/17/05	Buy	\$1,216.96	(2.09%)	\$215.66
06/24/05	Sell	\$1,191.53		(\$2,091.82)
06/16/06	Buy	\$1,251.54	(0.56%)	\$507.18
06/23/06	Sell	\$1,244.50		(\$1,135.23)
06/15/07	Buy	\$1,532.91	(1.98%)	\$286.65
06/22/07	Sell	\$1,502.56		(\$2,091.05)
06/20/08	Buy	\$1,317.86	(2.99%)	\$1,332.75
06/27/08	Sell	\$1,278.49		(\$3,439.50)
06/19/09	Buy	\$921.23	(0.25%)	\$83.16
06/26/09	Sell	\$918.90		(\$3,495.96)
06/18/10	Buy	\$1,117.51	(3.65%)	\$1,221.08
06/25/10	Sell	\$1,076.76		(\$4,416.18)
06/17/11	Buy	\$1,271.50	(0.24%)	\$2,114.58
06/24/11	Sell	\$1,268.45		(\$673.14)
06/15/12	Buy	\$1,342.84	(0.58%)	\$1,525.88
06/22/12	Sell	\$1,335.02		(\$1,363.82)

As you can see, it has been quite a streak of bearishness. Twelve out of fourteen years have closed down, including the last 10 in a row. So it would seem we may be entering a week seasonal period.

Most seasonal tendencies I have found I have also been able to think of why they may exist. Optimism going into a holiday or long weekend, and mutual fund flows occurring near the turn of the month are two such examples. In some cases I can't explain the "why", but it doesn't really matter if the edge has persisted for a long period of time. In this case the edge hasn't existed for *that* long. In fact, if you look back further, you'll find periods where this week appeared to show a bullish tendency. Below is the same seasonal study run from 1979 - 1989.

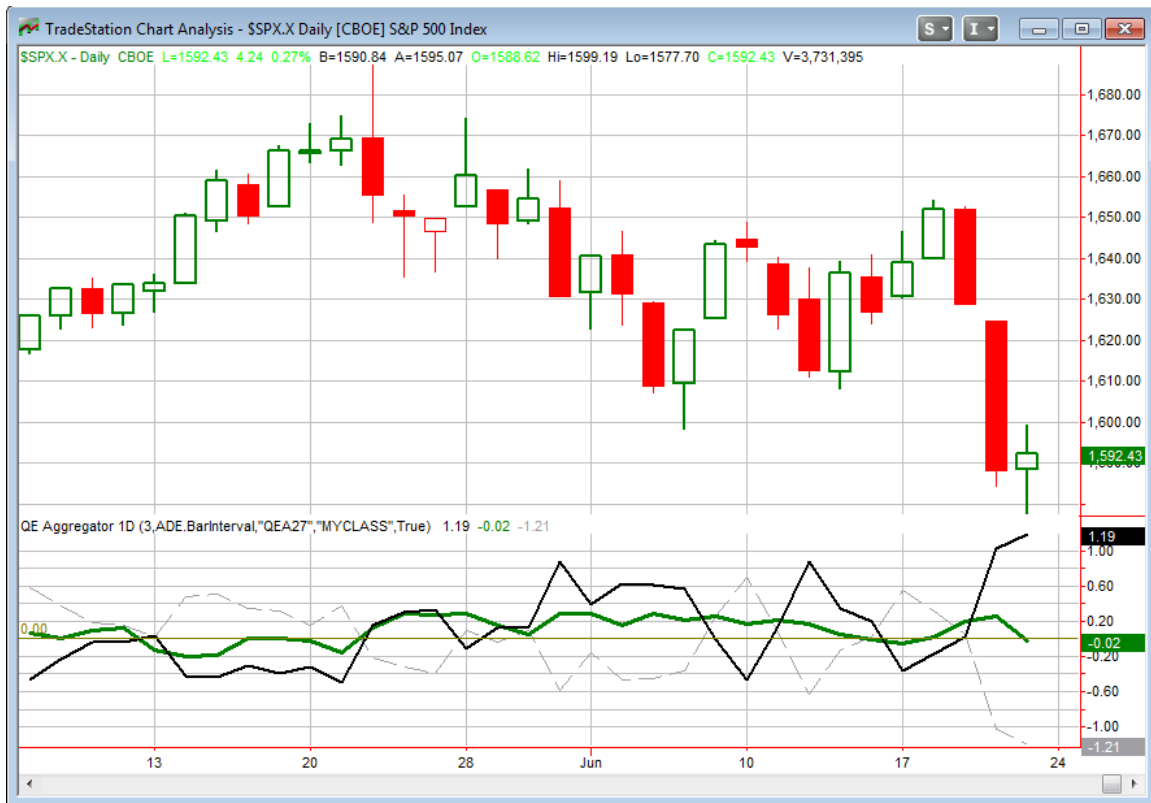
Weekly SPX performance following opex Friday in June.
\$100k/trade. 1979 - 1989.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
06/15/79	Buy	\$102.08	0.54%	\$1,057.32
06/22/79	Sell	\$102.63		(\$1,145.43)
06/20/80	Buy	\$114.05	1.71%	\$3,433.92
06/27/80	Sell	\$116.00		(\$613.20)
06/19/81	Buy	\$132.27	0.21%	\$1,534.68
06/26/81	Sell	\$132.55		(\$884.52)
06/18/82	Buy	\$107.27	1.73%	\$3,830.52
06/25/82	Sell	\$109.13		(\$876.08)
06/17/83	Buy	\$169.13	0.74%	\$2,139.42
06/24/83	Sell	\$170.39		(\$1,081.53)
06/15/84	Buy	\$149.02	3.65%	\$4,435.31
06/22/84	Sell	\$154.46		(\$335.50)
06/21/85	Buy	\$189.61	1.18%	\$1,180.48
06/28/85	Sell	\$191.85		(\$938.06)
06/20/86	Buy	\$247.58	0.82%	\$1,027.65
06/27/86	Sell	\$249.60		(\$1,265.42)
06/19/87	Buy	\$306.96	0.06%	\$1,075.75
06/26/87	Sell	\$307.15		(\$208.00)
06/17/88	Buy	\$270.67	1.15%	\$2,287.80
06/24/88	Sell	\$273.78		(\$1,162.35)
06/16/89	Buy	\$321.35	2.07%	\$2,068.15
06/23/89	Sell	\$328.00		(\$653.10)

So back then we had 11 years in a row of gains. For me, this somewhat diminishes the probability of a bearish seasonal edge actually existing. Not to say that it doesn't, but I'm not inclined to give it a whole lot of weight. In any case, I think it is most likely offset by the strong liquidity environment.

The Aggregator is not factoring in the results from the QE Buying Power Index studies shown above since the trigger and exit are so similar to the other bullish studies on the board. So I elected to ignore this possible seasonal influence as well. Subscribers are welcome (and generally encouraged) to take issue with my interpretations of the data. And you could certainly make a case that the numbers should be skewed more in either direction. I do my best to present the evidence, and provide my own interpretation. But my interpretation is not always the "right" one.

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



The “Weak Bounce” study caused the green Aggregator Line to dip down just slightly below zero. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line is now very high above 0. The positive Differential Line reading means the SPX is strongly oversold versus recent expectations. So expectations are negative but the SPX is very oversold. 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 expected to turn back positive on Monday. Of course this could change if more bearish evidence emerges. The Differential Pivot will be 1,630.51 on Monday. This is a whopping 2.4% above Friday's close. In other words, it will likely take a multi-day bounce or consolidation to work off the oversold condition.

The market certainly seems to be in a bit of a tricky place. The aggregator is just barely negative, but only expected to stay there for a day. Meanwhile SPX is more oversold than has been in a very long time. I currently have a small long index position. Most of the time when the aggregator system turns neutral, I'll simply exit my position. In this case, I'm not inclined to do that. We still have a number of studies suggesting an upside reversion, and with the positive liquidity environment the chances of that reversion

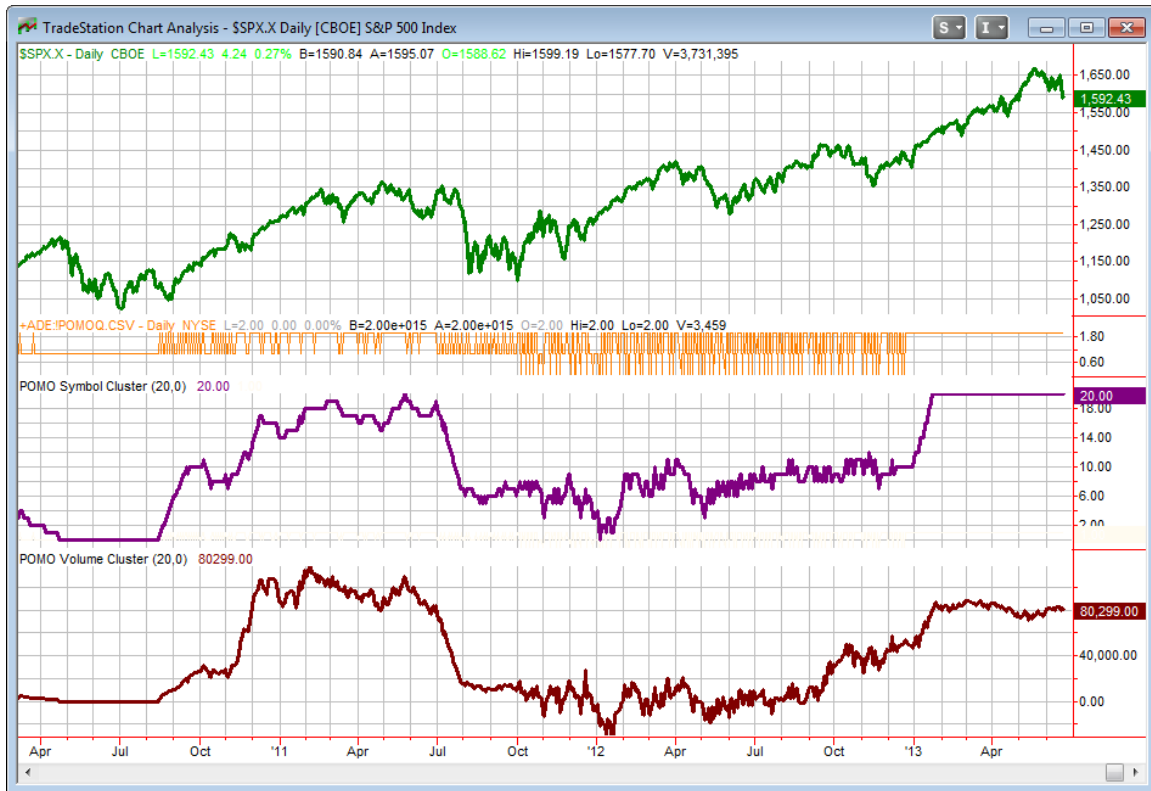
increase substantially. Additionally, if I were to exit my current long position, I would probably be looking to get right back in at the close on Monday. So I will ride this out a little bit. If the oversold condition starts getting worked off, I won't miss out on gains. If the "weak bounce" study holds true and we get a further pullback in the next day or two, then that may offer me an opportunity to increase my (currently small) position size.

Intermediate-term Outlook (2 weeks – 2 months)– updated 6/24 – somewhat bullish

SPX suffered another difficult week this past week. It is now trading below its 10-week moving average for the first time in 2013. I reduced my bullish stance a few weeks ago, and it looks like I should've reduced it more than I did. But from a studies standpoint I am not seeing a whole lot of evidence suggesting a major top. No new compelling intermediate-term studies emerged this past week. But the Fed is providing some nice food for thought.

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 remains in its 2013 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 \$21.6 billion, which should help the market some this upcoming week.

This week is expected to see the strongest Fed buying of June. Inflows between POMO and AMBS are expected to reach over \$25 billion. This should allow June to finish somewhat strong and give early July a possible boost.

The July POMO and AMBS purchase schedules are set to be released on Friday afternoon. At this point we do not expect to see any tapering for several months. I anticipate liquidity flows in July will be similar to what we have seen the past few months.

Market action this past week raises the question of how much do you want to try and anticipate liquidity flows when determining whether they will provide a positive or negative backdrop for the environment. My long-held belief is that when the current round of quantitative easing ends the market will likely struggle. The primary reason for this belief is that during all periods since 2005 where there has not been quantitative easing, the market has struggled. Of course, this isn't the secret it once was. But I'm not sure how much of a secret it was during QE1 or QE2. In those cases the market did not

begin to suffer until the liquidity flows ended, or were greatly reduced. So I am not inclined to believe that REAL struggles will occur prior to the Fed “easing off the gas pedal”, to steal a phrase from Bernanke. Of course every time there is news with regards to tapering or ending the current Fed program, the market gets spooked. And that seems like what is happening right. The market got spooked thinking about the end. But I believe it should continue to reap the benefits of positive liquidity flows until such time that they are not as powerful.

My outlook is largely unchanged from last week. We still have a fair amount of bullish studies active, with the Hindenburg Omen being the only bearish one at this point. Momentum, breadth, and liquidity all favor the upside. The trend is not as clear as it was a few weeks ago, and the market has been chopping around quite a bit. At this point I am leaving the outlook at “somewhat bullish” – the same as last week. From a trading standpoint that means I will be favoring longs and being extra selective about any shorts.

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

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	6/20/2013	\$158.56	\$159.07	0.32%		Aggregator

SPY entry price is dividend-adjusted.

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