

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 4, 2013

Volume 6 Issue 213

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- Our “Study of Tops” breadth indicators continue to diverge, which is an intermediate-term warning sign.
- Fed liquidity flows will remain strong in November, with this upcoming week being especially strong.

## *Short-term Outlook*

### *The Bottom Line*

The evidence is pointing higher but SPX is on the verge of moving from short-term oversold to short-term overbought. So I will only look to take on new exposure if there is a decent-sized decline on Monday.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active - Short Term</b>				
November 1, 2013	Dn 2 poor close end of month >200	1-5 days	Bullish	2.20%
November 1, 2013	1st 5-low in 10 days	1-4 days	Bullish	1.70%
October 31, 2013	Strong drop from 50-day high	1-4 days	Bullish	1.20%
<b>Active - Long Term</b>				
October 25, 2013	SPX > 50,2 Bollinger Band	1-50 days	Bullish	
October 24, 2013	5 up to 50-high, then 1 down	1-10 days	Bullish	2.00%
October 21, 2013	70% Advancing Issues 3 Days In Row	1-75 days	Bullish	10.60%
July 22, 2013	New High Divergence (Study of Tops)	int term	<b>Bearish</b>	
May 6, 2013	Nasdaq leading SPX	int term	Bullish	
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>				
October 31, 2013	Weak breadth < 1% drop from 50	1-2 days	<b>Bearish</b>	

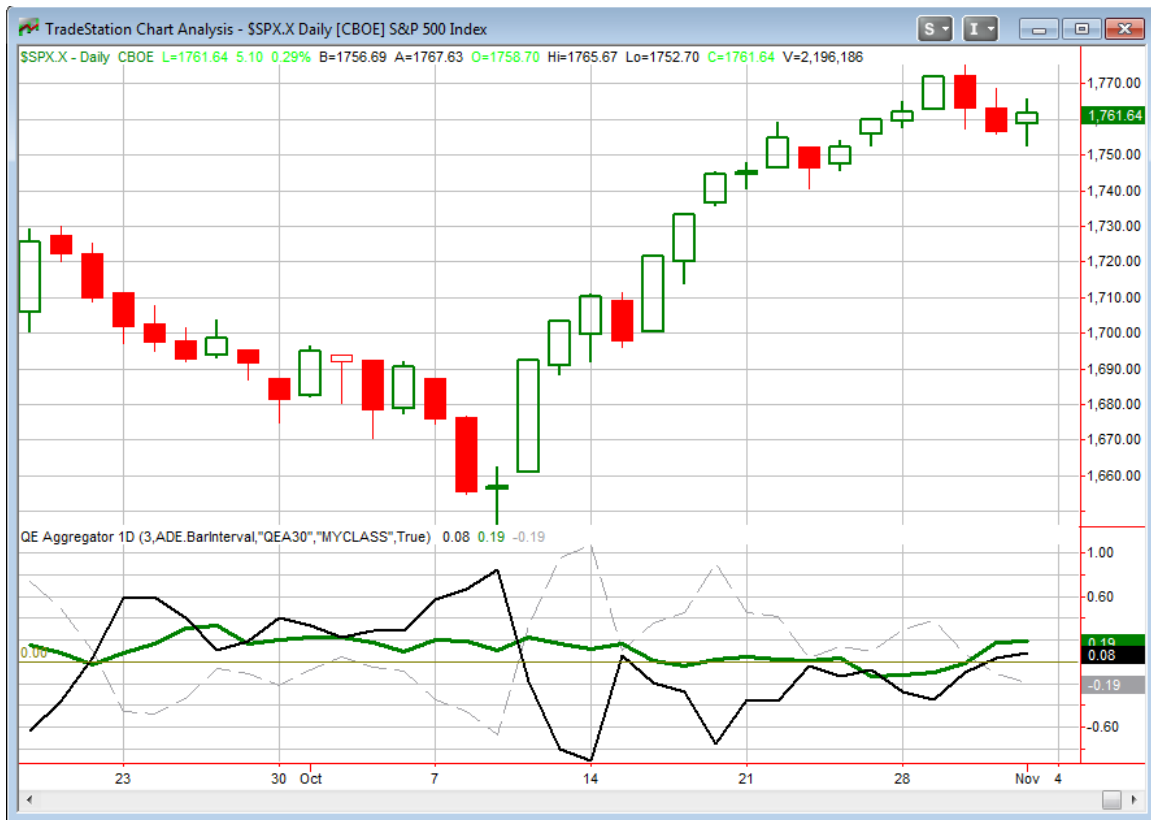
**The Evidence**

Trading was mixed on Friday with large caps outperforming smallcaps. The SPX rose 0.3%, and the Nasdaq gained 0.1%, the but Russell 2000 declined 0.4%. Breadth was also mixed as the NYSE Up Issues % was 45% and the Up Volume % was 55%. Total NYSE volume declined some from Thursday's level.

The bounce on Friday for SPX was not unexpected. Thursday night the Aggregator formation turned bullish. But it came after a quite shallow 2-day pullback. Wondering what this might mean, I looked at other times SPX followed a 50-day high with a 2-day pullback that remained above the 10ma, and then a rise the next day. Unfortunately, I was unable to identify any consistent tendencies.

Back and forth action like we have seen the last few days will often coincide with a dearth of new studies. And that is what we have tonight. There is really nothing worth going over in detail. The studies from the last few nights that looked at pullbacks from 50-day highs all suggested there should be more of a bounce than this. The lone short-term study with a bearish tilt expired on Friday, so the remaining short-term evidence is all pointing to more of a bounce.

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



Without any new studies being added tonight the green Aggregator Line remained above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line also rose above 0. The positive Differential Line reading means the SPX is oversold versus recent expectations. So expectations are positive and the SPX is mildly oversold. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. This caused the Aggregator signal to remain long at the close.

Based on the current studies, expectations are set to remain positive on Monday. Of course this could easily change if new bearish evidence emerges. The Differential Pivot will be *inverted* at 1759.28 on Monday. That is a little more than 2 points *below* Friday's close. An inverted Differential Pivot simply means that the Differential Line would cross zero if SPX closed flat. So in this case, for SPX to remain "oversold verses expectations" it will need to close down at least this much.

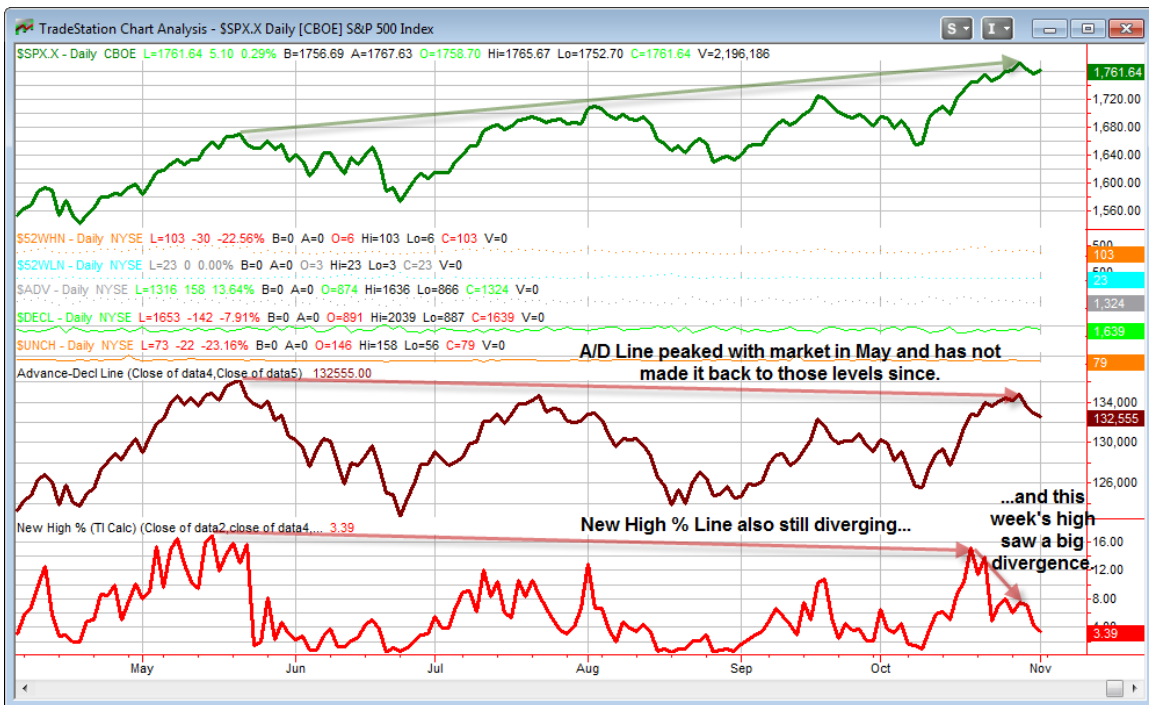
When the Differential Pivot is inverted that is generally not a great time to initiate new positions – at least index positions early in the day. This is because the potential reward is limited. In this case, expectations point higher, but if they are right, and the market closes up at all on Monday, then the market will be considered overbought and in a

position where I would normally take profits. But a move lower would most likely keep the Aggregator in a bullish configuration. So I may look to take on some long exposure on Monday, but only if the market closes down a fair amount.

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

SPX rose again this week for the 4<sup>th</sup> week in a row and made new highs again on Monday and Tuesday. So the uptrend remains in place, as it has throughout all of 2013. No new studies emerged with intermediate-term implications, but our breadth and liquidity-based indicators are providing plenty to discuss this week.

The “Study of Tops” indicators diverged even worse this week. While the market peaked on Tuesday (and Wednesday intraday), the % of stocks hitting new highs was well below the previous week. This can be seen in the chart below, which is an updated version of the ones seen in the Study of Tops.



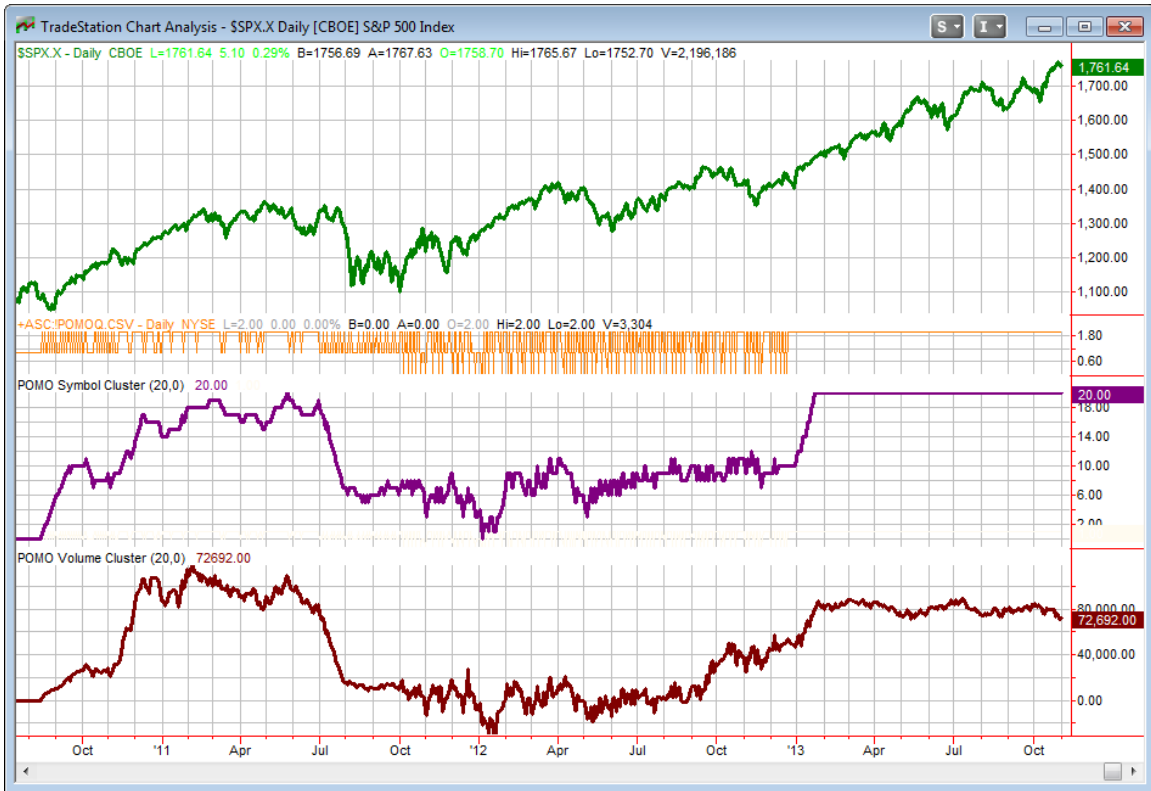
The May SPX high was accompanied by new highs in both the A/D Line and the New High %, and that provided us some confidence that the next price top prior to a major decline was unlikely to occur until at least July. This held true and the market has continued higher, but the New High % and A/D Line have failed to keep up.

This opens up the possibility of a major top being put in. Note I said possibility, not probability. It needs to be understood that while the narrowing of New Highs and/or the turn down in the Advance/Decline Line has been a prerequisite for a top to take place, these breadth conditions have not been very useful in timing the tops. Often such divergences have persisted for many months, or even years. I therefore view these breadth divergences as possible warning signs – not as timing signals.

If the market continues higher and the New High % and A/D Line rally to new highs as well, then that would suggest the market is unlikely to reach a major price top for at least another 2 months. I'll continue to keep an eye on these indicators.

I update the intermediate-term POMO/QE chart each week. For those not familiar, below is a brief description.

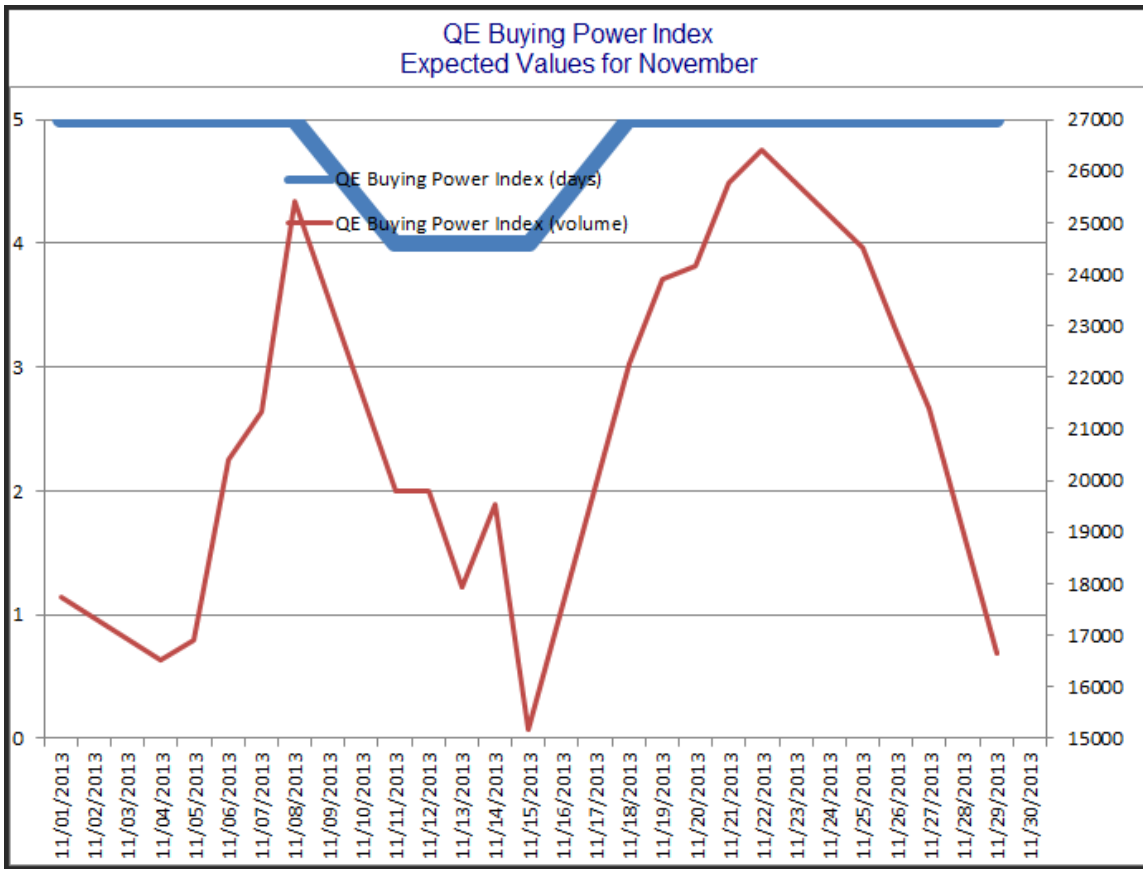
*POMO stands for Permanent Open Market Operations and it is how the Fed has gone into the open market to buy securities over the last several years. The net effect of this buying is an influx of cash into the system. It appears a portion of that cash makes its way to the stock market and works as a bullish 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 down near the very bottom end of 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 \$17.7 billion, which is a little below typical so far for 2013. It is an amount that is still providing stimulus, just less stimulus than most weeks this year.

Expected flows for this upcoming week are expected to rise to \$25.4 billion. This could be the highest 1-week inflow in months, and should provide a nice breeze at the market's back towards the end of this week and into next week.

With the release of the November schedule on Thursday I was able to generate the expected values for the QE Buying Power Index for November. I have pasted it below and updated the QE Buying Power Information page as well.



As you can see, it is very back and forth this month. Every other week we see an alternate of high and low readings. The strong flows this upcoming week will lead us to very high readings by Friday. But the next week we will see some low readings. From a liquidity standpoint, the bears will have an easier time getting traction and pushing prices lower during the periods at, or within a few days after, we see low readings.

The overall intermediate-term outlook remains somewhat bullish. Liquidity flows are expected to be strong again in November and the foreseeable future. The breadth divergences noted by the QE Study of Tops continue to be a problem and suggest the market could undergo a major decline. But the trend remains up, the Nasdaq is still leading, and trend strength and momentum also suggest a rally continuation. So I am keeping my outlook at somewhat bullish. I will continue to favor the long side with my swing trades and will be extra cautious 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 @ \$175.20 LIMIT ON CLOSE.** Based on the short-term outlook above. This would mean Monday's close would be below Friday's low. If it drops, but not this far, I will probably look to buy a little on Tuesday morning, but I want to evaluate again tomorrow night before committing to that.

## **Current Open Trade Ideas**

*None. Unfortunately, neither trade idea from Friday received a fill.*

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