

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 2, 2013

Volume 6 Issue 232

Market Overview



Signals Overview

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

Tonight's Research Points

- When SPX closes down but breadth is strong, it has often led to gains over the next few days.
- 3 days of strong Nasdaq breadth are often followed by a down day.
- Monday after Thanksgiving has historically been weak.
- Poor closes on the last day of the month have increased the upside edge for the 1st of the next month.
- When the last trade day of the month is a Friday, then Monday has done very well during uptrends.
- The Nasdaq is now back in a leading position, which has typically meant a favorable environment for stocks.
- December POMO purchases are front-loaded, with no activity after the 23rd.
- “Study of Tops” indicators are still diverging.

Short-term Outlook

The Bottom Line

The Aggregator is somewhat bullish. Monday's seasonality is mixed but overall evidence is pointing higher. I like the long side but will not get too aggressive yet.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active - Short Term				
December 2, 2013	1st of Month - poor close & Fri	1 day	Bullish	
December 2, 2013	SPX dn. Up Issus > 55%	1-3 days	Bullish	1.10%
December 2, 2013	Monday after Thanksgiving bearish	1 day	Bearish	
December 2, 2013	Nasdaq Up Iss % > 60% 3 days in row	1 day	Bearish	
Active - Long Term				
December 2, 2013	Nasdaq leading SPX	int term	Bullish	
November 21, 2013	3-day pullback. Low 3/10 Offset HV	1-10 days	Bullish	
October 25, 2013	SPX > 50,2 Bollinger Band	1-50 days	Bullish	
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	Bearish	
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				
November 29, 2013	VIX up SPX 50-high 2 days in row	1 day	Bearish	
November 29, 2013	Thanksgiving Fri Bullish	1 day	Bullish	

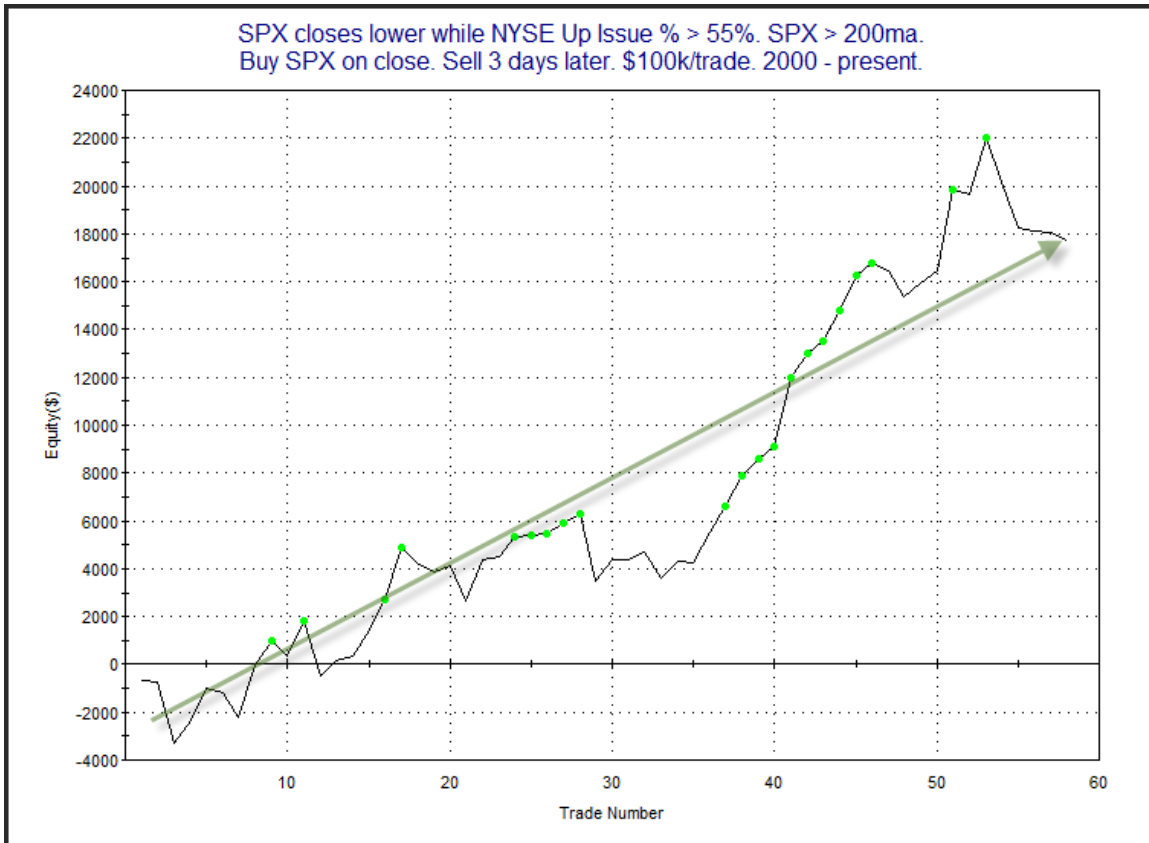
The Evidence

Friday looked like a dull drift higher until the last few minutes. Then a sudden swoosh turned positive numbers to mixed. The SPX declined 0.1%, the Nasdaq was up about 0.4%, and the Russell 2000 gained 0.1%. Breadth was positive as the NYSE Up Issues % was 56% and the Up Volume % was 61%. Total NYSE volume was very light with many traders taking the day off and a 3-hour shortened session.

Breadth was unusually strong on Friday for a day that the SPX declined. The study below was last seen in the 9/25/13 Letter. It looks at days like Friday where SPX declined despite strong breadth. Results are updated.

SPX closes lower while NYSE Up Issue % > 55%. SPX > 200ma. Buy SPX 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	17,388.63	54	32	22	59.26	1,374.74	3,616.92	-1,209.23	-4,012.80	1.14	1.65	322.01
4	17,735.02	56	33	23	58.93	1,308.72	3,429.00	-1,106.64	-2,921.28	1.18	1.70	316.70
3	17,730.27	58	37	21	63.79	1,012.83	3,373.50	-940.21	-2,852.01	1.08	1.90	305.69
2	17,065.59	59	40	19	67.80	841.41	3,025.12	-873.19	-3,119.03	0.96	2.03	289.25
1	13,777.66	61	35	26	57.38	719.39	2,484.00	-438.51	-1,348.29	1.64	2.21	225.86

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



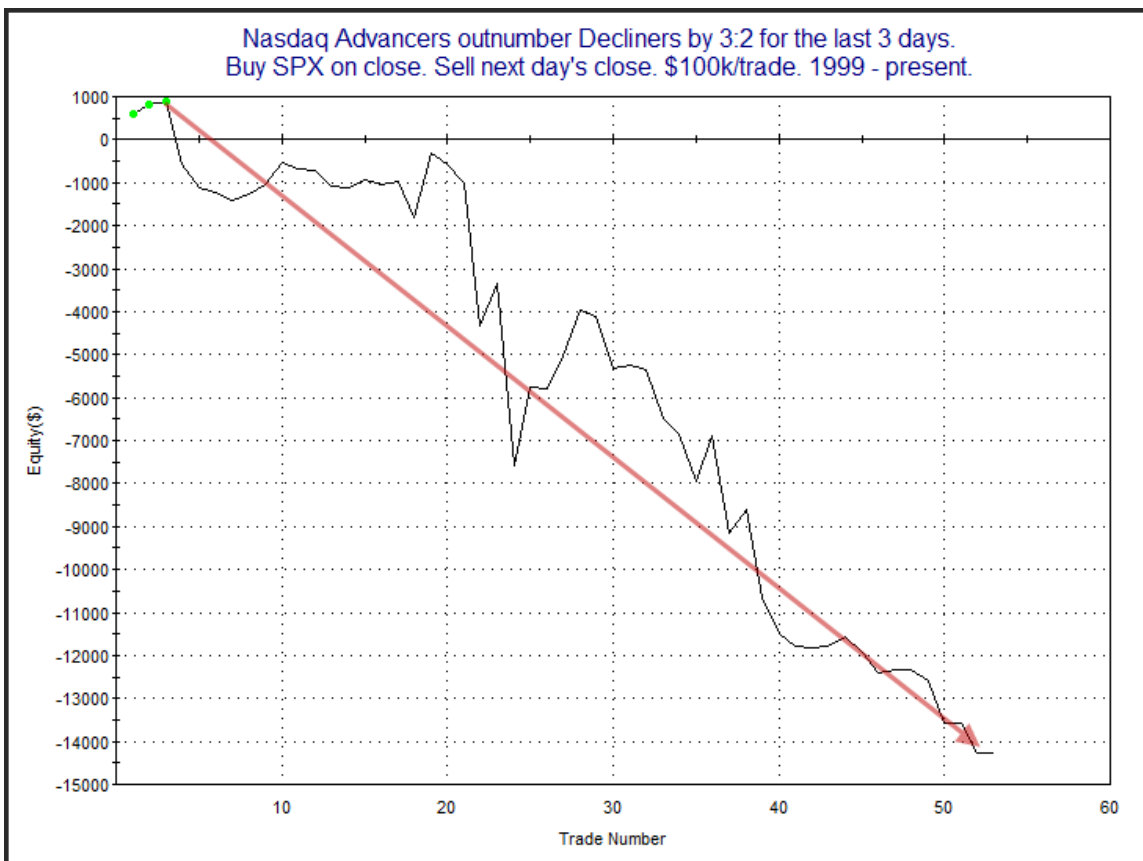
While the curve certainly appears choppy, it has persisted upwards. I believe this study is worth taking into consideration and I've included it among the active studies.

But not all breadth studies were optimistic. The study below suggested Monday could be down. It looked at other times Nasdaq advancers outnumbered decliners by more than 3:2 for 3 days in a row. I last showed it in the 6/11/13 letter. Results are updated.

Nasdaq Advancers outnumber Decliners by 3:2 for the last 3 days.
Buy SPX on close. Sell next day's close. \$100k/trade. 1999 - present.

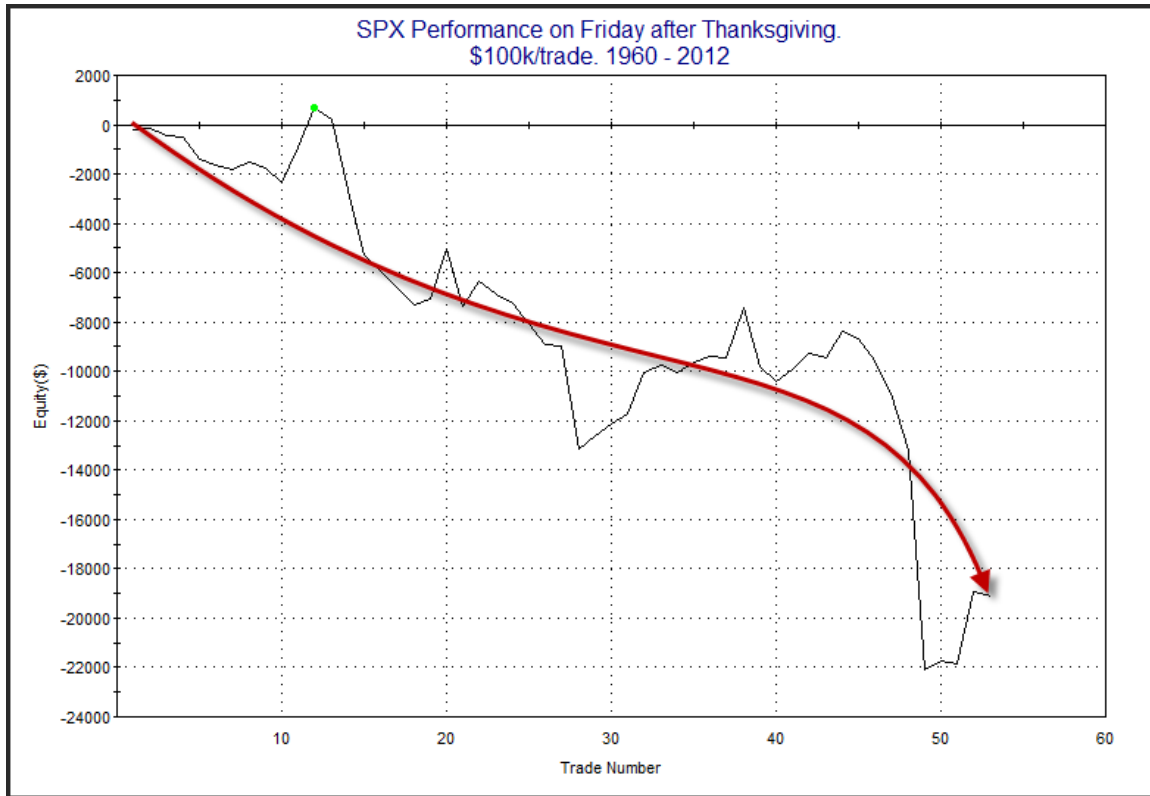
TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	(\$14,278.06)	Profit Factor	0.42
Gross Profit	\$10,253.23	Gross Loss	(\$24,531.29)
Total Number of Trades	53	Percent Profitable	39.62%
Winning Trades	21	Losing Trades	32
Even Trades	0		
Avg. Trade Net Profit	(\$269.40)	Ratio Avg. Win:Avg. Loss	0.64
Avg. Winning Trade	\$488.25	Avg. Losing Trade	(\$766.60)
Largest Winning Trade	\$1,857.24	Largest Losing Trade	(\$4,241.94)

The numbers imply a bit of a downside edge. I also produced an equity curve.



It's definitely choppy, but it has moved from upper left to lower right for a long time. I believe it is worth some consideration.

There is also quite a bit to consider from a seasonality standpoint for Monday. Last week I showed the chart below, which indicates the bearish tendency the market has had on the Monday after Thanksgiving.



The average instance lost \$361 (0.36%), but a large part of the losses were thanks to the 2008 debacle. It is not a smooth curve at all, but the general slope has been down for a long time, so it is likely worth some consideration.

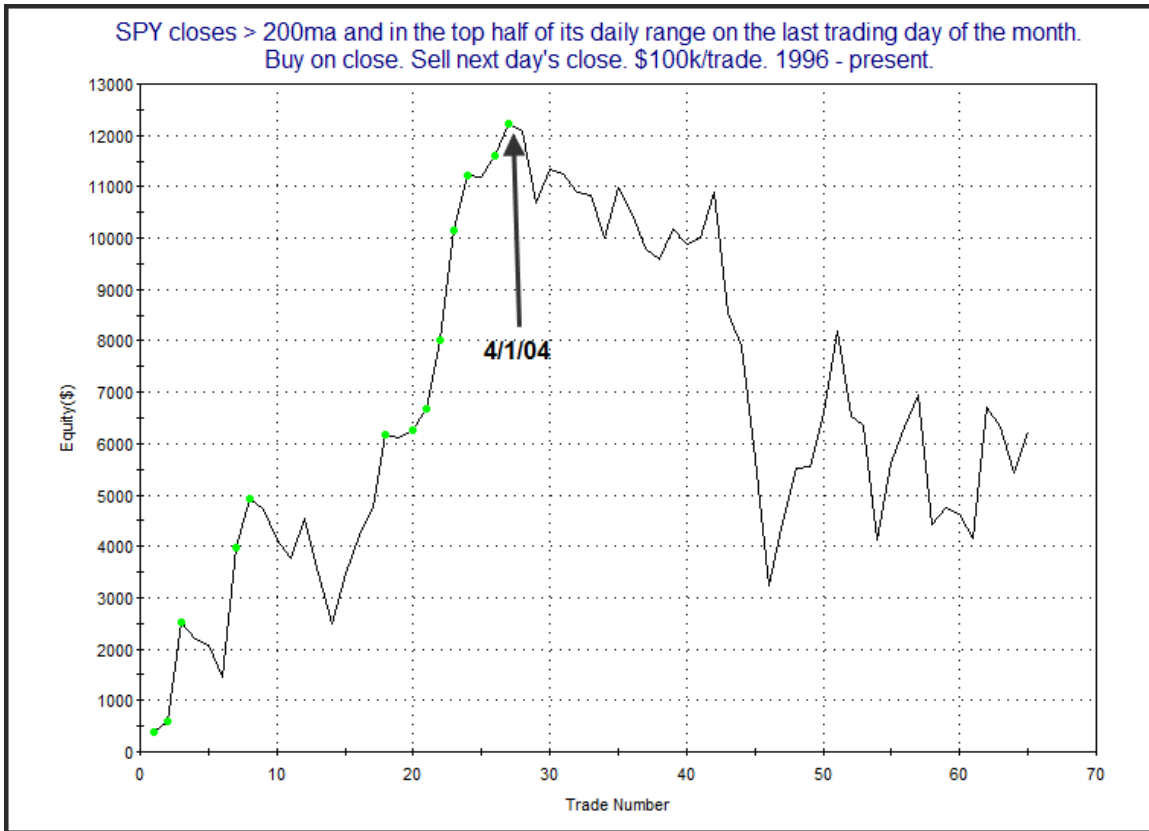
In Thursday night's letter I discussed how the edge for the 1st day of the month has been largely dictated by how the market finished on the last day of the previous month. Friday's late selloff appears to be a plus for Monday. I have copied the studies related to this from Thursday night's letter below.

The 1st day of the month has been notorious for being a strong seasonal day. This is no big secret and has been documented by many people. Of course over the years there are a number of traders that have tried ways to take advantage of this strong seasonality. So

much so that it will often drive the price up on the afternoon of the last day of the month. When this occurs it takes a lot of the "1st day" edge away. But times where the market fails to rally ahead of the end of the month, the 1st day edge has been especially strong. In the 11/1/13 Letter I examined all 1st days of the month when SPY was above its 200ma and broke them down by whether the previous day closed in the top or bottom half of the daily range. First let's look at times the market closed in the top half of its range on the last day of the month.

TradeStation Performance Summary Collapse ↕			
All Trades			
Total Net Profit	\$6,232.50	Profit Factor	1.25
Gross Profit	\$31,169.63	Gross Loss	(\$24,937.13)
Total Number of Trades	65	Percent Profitable	50.77%
Winning Trades	33	Losing Trades	32
Even Trades	0		
Avg. Trade Net Profit	\$95.88	Ratio Avg. Win:Avg. Loss	1.21
Avg. Winning Trade	\$944.53	Avg. Losing Trade	(\$779.29)
Largest Winning Trade	\$2,562.30	Largest Losing Trade	(\$2,515.60)

The numbers here don't suggest a substantial edge. Below is the profit curve.



This paints an even bleaker picture. A close in the top half of the daily range cannot be trusted to follow through the next day.

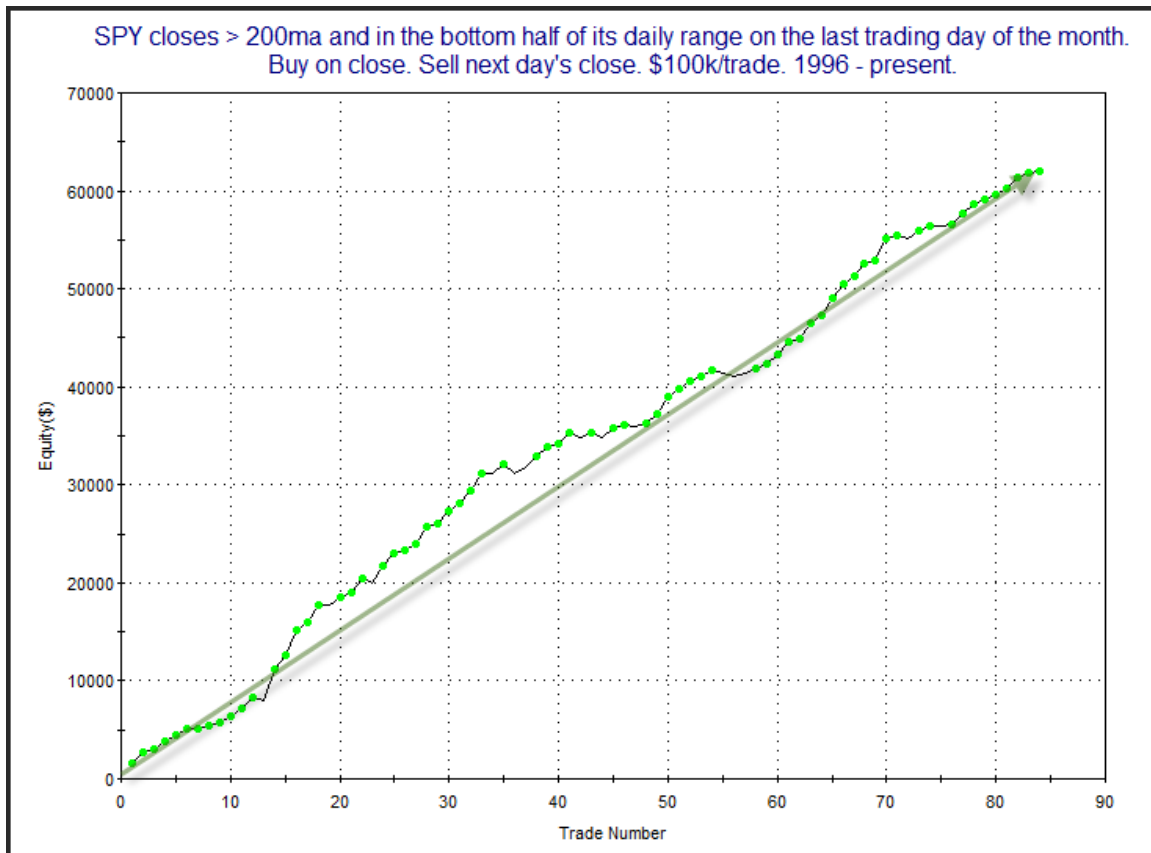
Now let's look at the stats when SPY closed in the bottom half of its daily range.

SPY closes > 200ma and in the bottom half of daily range on the last trading day of the month.
Buy on close. Sell next day's close. \$100k/trade. 1996 - present.

TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	\$62,034.36	Profit Factor	17.13
Gross Profit	\$65,880.30	Gross Loss	(\$3,845.94)
Total Number of Trades	84	Percent Profitable	85.71%
Winning Trades	72	Losing Trades	12
Even Trades	0		
Avg. Trade Net Profit	\$738.50	Ratio Avg. Win:Avg. Loss	2.85
Avg. Winning Trade	\$915.00	Avg. Losing Trade	(\$320.50)
Largest Winning Trade	\$3,295.88	Largest Losing Trade	(\$885.28)

The stats here are phenomenal. Gains absolutely blow away losses in every category. Gross gains are over 17x the size of gross losses. And the average win is actually bigger

than the largest loss. That's an incredible stat when you are looking at a sample size of 84 instances. And the profit curve...



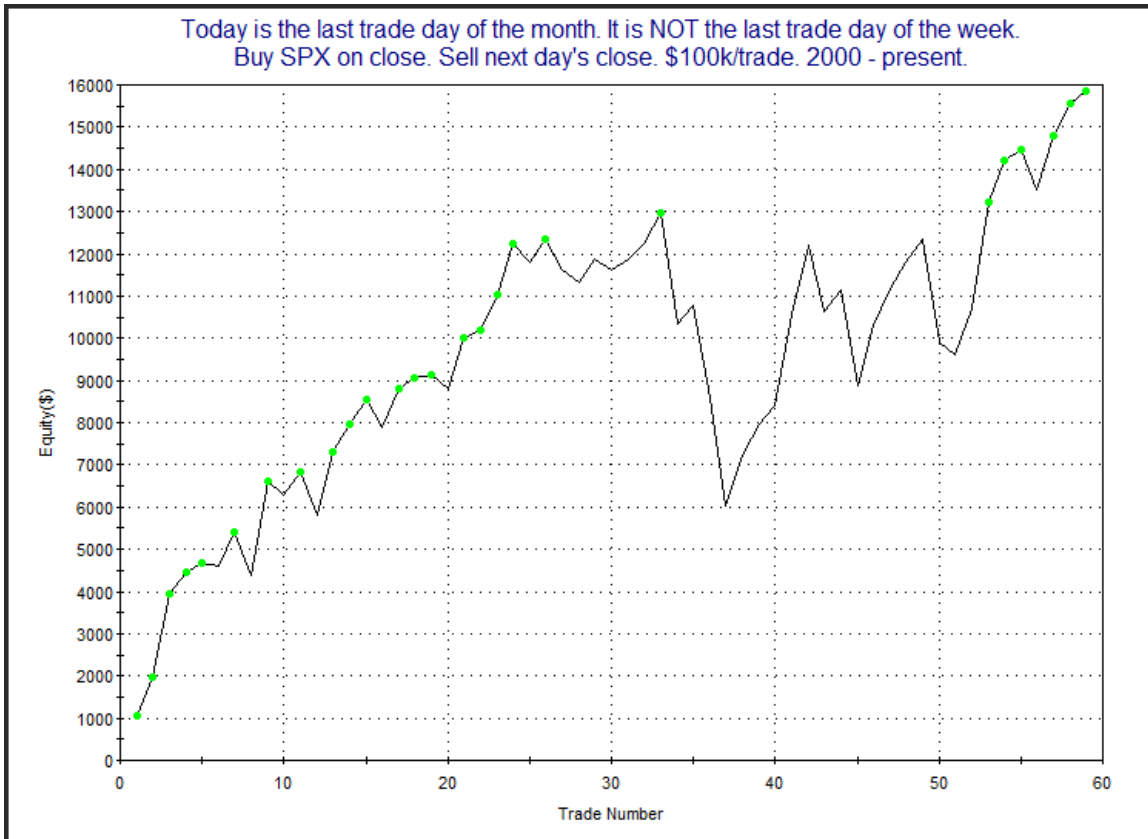
You will be hard pressed to find a long-term profit curve much straighter and more impressive than this one.

In the 12/2/12 letter I compared instances when the last trading day of the month arrived on a Friday (or Thursday if Friday was a holiday) versus times the turn of the month happened during the week. The results were very interesting, and I have updated them all below. First, here are the stats when turn of the month has happened mid-week.

Today is the last trade day of the month. It is NOT the last trade day of the week.
Buy SPX on close. Sell next day's close. \$100k/trade. 2000 - present.

TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	\$15,857.82	Profit Factor	1.79
Gross Profit	\$35,840.85	Gross Loss	(\$19,983.03)
Total Number of Trades	59	Percent Profitable	69.49%
Winning Trades	41	Losing Trades	18
Even Trades	0		
Avg. Trade Net Profit	\$268.78	Ratio Avg. Win:Avg. Loss	0.79
Avg. Winning Trade	\$874.17	Avg. Losing Trade	(\$1,110.17)
Largest Winning Trade	\$2,536.10	Largest Losing Trade	(\$2,617.60)

Results here appear mildly bullish. Here is a profit curve to see how it's played out over time.

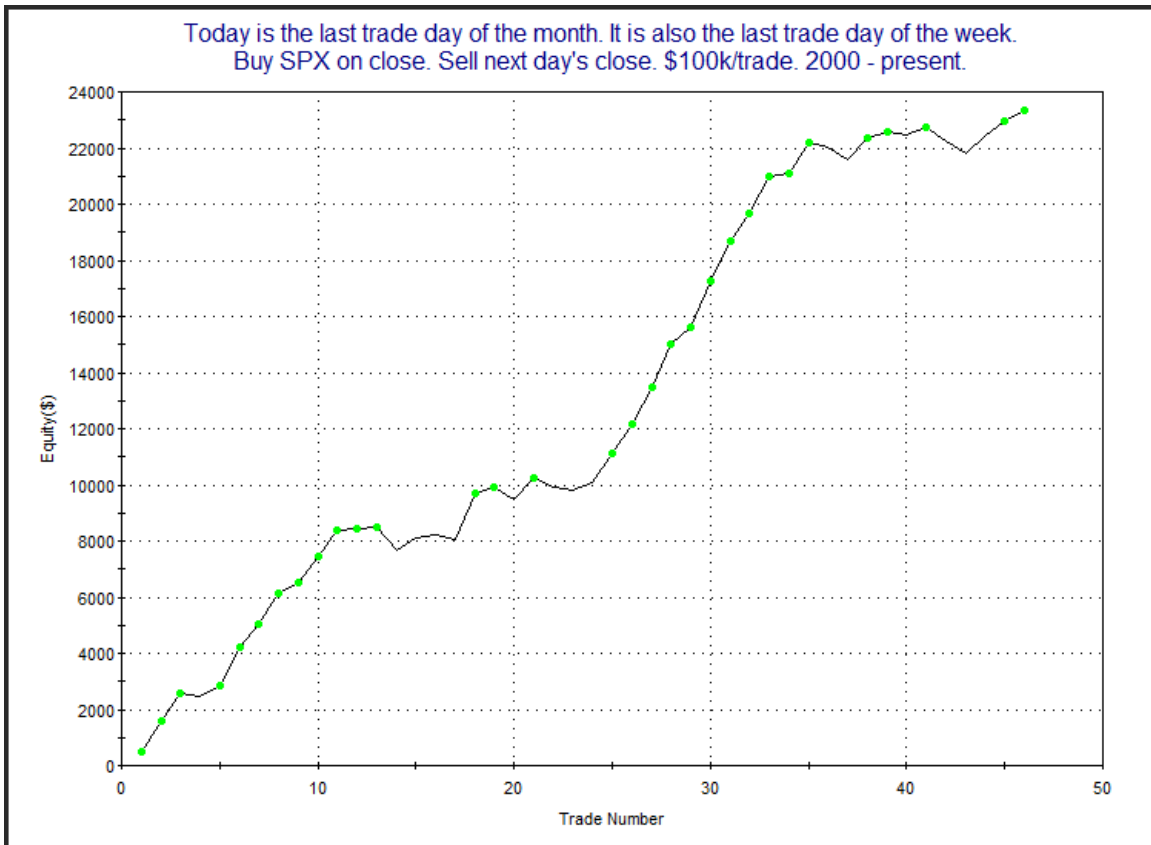


This edge struggled for a while but has recently done a bit better. Overall, it appears to be a pretty choppy move higher, suggesting a bit of an upside edge, but not overwhelming. But what of times like now when the month turns on a weekend?

Today is the last trade day of the month. It is also the last trade day of the week.
Buy SPX on close. Sell next day's close. \$100k/trade. 2000 - present.

TradeStation Performance Summary		Collapse ^	
All Trades			
Total Net Profit	\$23,362.68	Profit Factor	7.61
Gross Profit	\$26,896.89	Gross Loss	(\$3,534.21)
Total Number of Trades	46	Percent Profitable	76.09%
Winning Trades	35	Losing Trades	11
Even Trades	0		
Avg. Trade Net Profit	\$507.88	Ratio Avg. Win:Avg. Loss	2.39
Avg. Winning Trade	\$768.48	Avg. Losing Trade	(\$321.29)
Largest Winning Trade	\$1,638.40	Largest Losing Trade	(\$807.70)

These numbers are much, much stronger. And below is the profit curve.



This is an impressive looking curve to go with the impressive numbers. And it would seem to suggest a decent upside edge for Monday.

So between the turn of the month occurring on a weekend, and the poor finish on Friday, there are a few seasonal studies with bullish outlooks for Monday, despite it being the Monday after Thanksgiving.

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



The current mix of studies has the green Aggregator Line a little above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line is also above 0. The positive Differential Line reading means the SPX is oversold versus recent expectations. So expectations are positive and the SPX has underperformed over the last few days. 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.

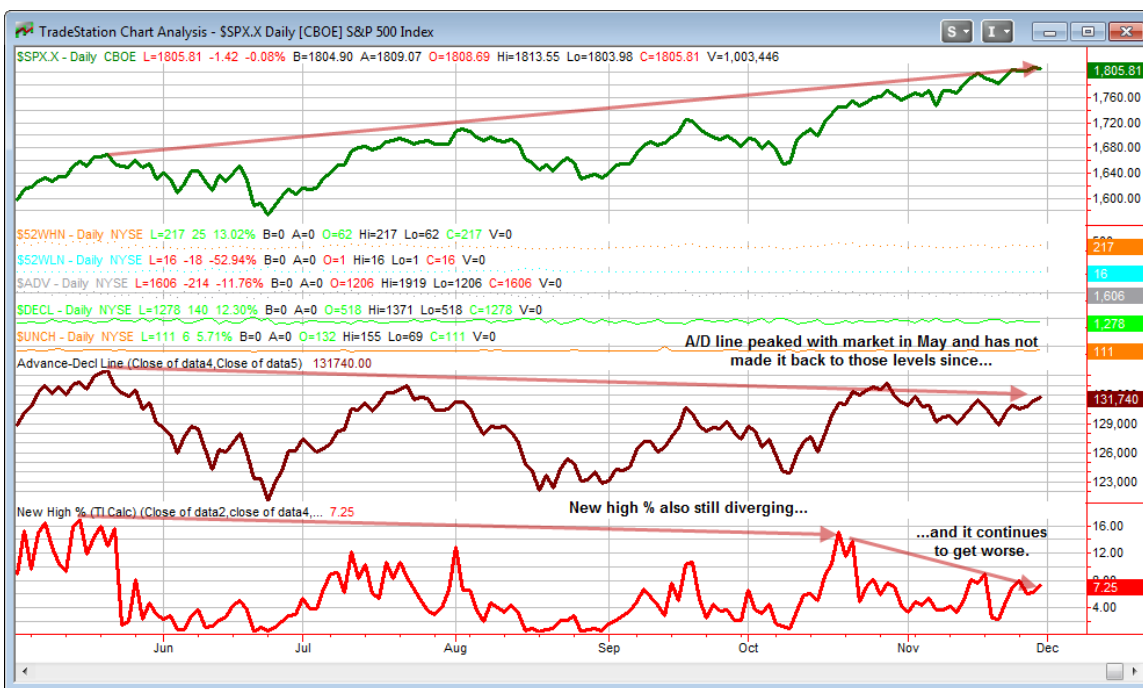
With the current active studies, expectations are set to remain bullish on Monday. Of course this could easily change if new bearish evidence emerges. The Differential Pivot will be 1806.14 on Monday. That is just 0.33 points above Friday's close. So any down close will leave SPX oversold, and just about any up close will turn it overbought.

There appears to be a bit of an upside edge here. But SPX is only marginally oversold and if it moves in the anticipated direction it will quickly become overbought. Therefore, the opportunity does not appear terribly large. I did take on some long exposure near the close on Friday, and I may add a bit more on Monday. I think the edge is playable, but without much short-term evidence to go on beyond Monday, I'll be taking it slow at this point.

Intermediate-term Outlook (2 weeks – 2 months) – *updated 12/2 – bullish*

The market's up streak continued as the SPX closed higher for the 8th week in a row. And despite closing down 0.1% on Friday it did make a new intraday high.

But even with the continued rally, the Study of Tops indicators remain highly divergent. While I have updated the chart below, the situation has not changed, so I simply copied my comments from last week underneath the chart.



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.

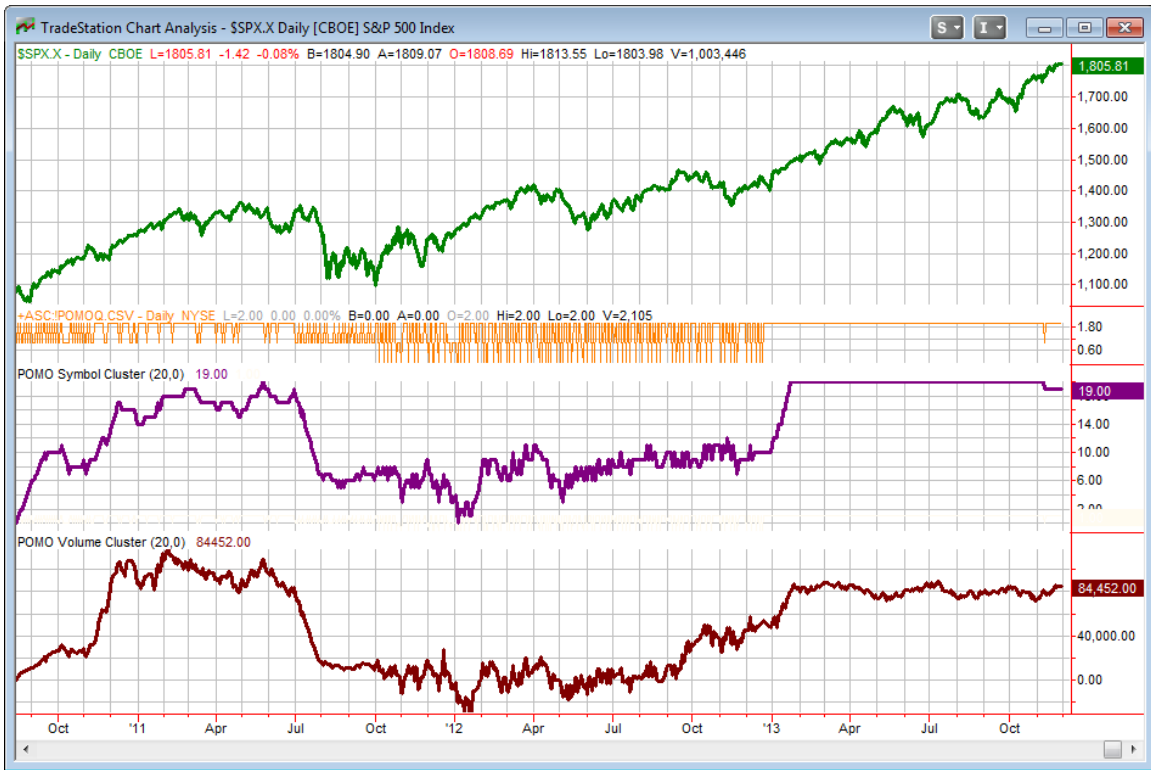
If the market continues higher and the New High % and A/D Line rally to new highs as well, then that would suggest the market is unlikely to reach a major price top for at least another 2 months. I'll continue to keep an eye on these indicators. For now they remain highly divergent. And the New High % is less than half of what it was at the May top. So the rally is occurring with fewer and fewer stocks participating. And from this point it will take a quite bit of work to get the New High % back to the May level.

One indicator that is back in a bullish formation is the SPX/NASDAQ Relative Strength Indicator that can be found on the charts page. Since the inception of the Nasdaq, the SPX has gained 1674.39 points when then Nasdaq was in leading position and just 30.73 points when the SPX is leading. The spread has not been as great in the last few years, but I would still prefer to see a leading Nasdaq. More information on the indicator may be found [in this old blog post](#). Any subscriber who wants to download the model may do so on [the Downloads page](#). The data in the Excel version has not been updated in a while, but the calculations are all there.

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

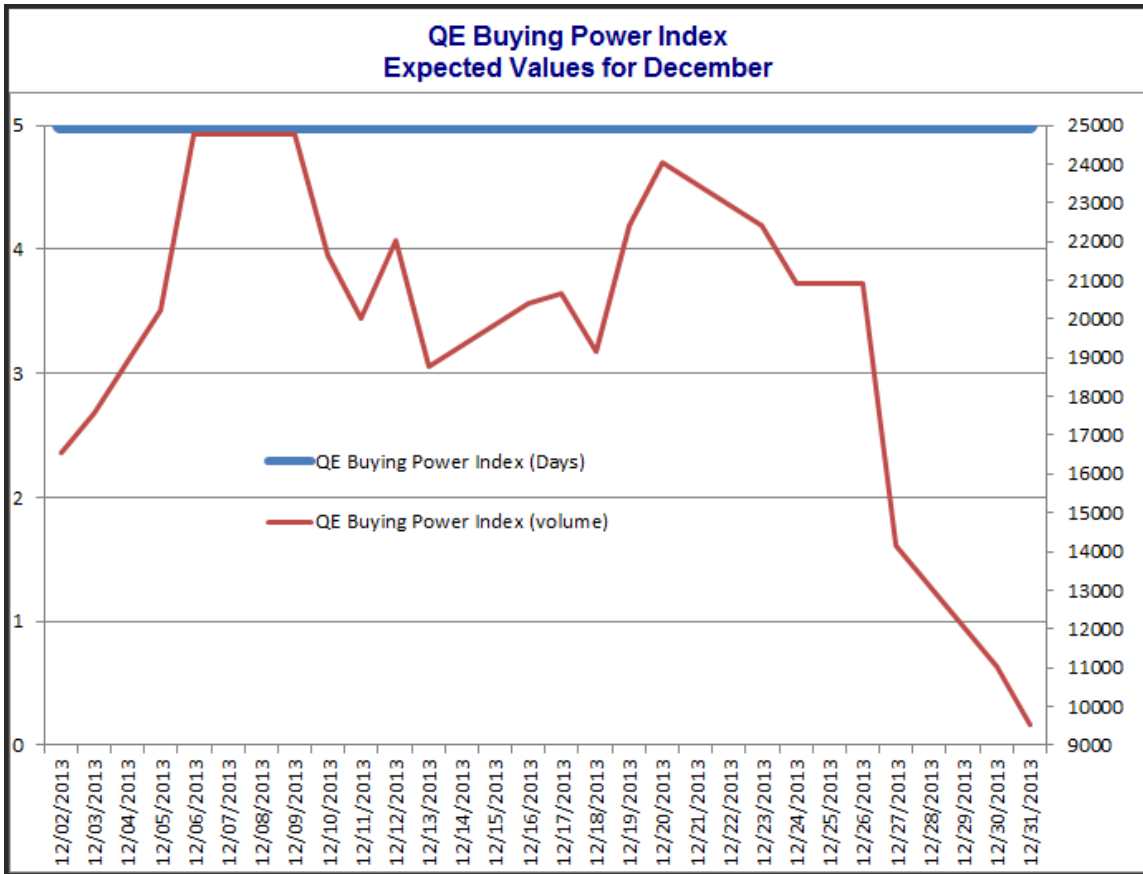
POMO stands for Permanent Open Market Operations and it is how the Fed has gone into the open market to buy securities over the last several years. The net effect of this buying is an influx of cash into the system. It appears a portion of that cash makes its way to the stock market and works as a bullish 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 near the high end of its 2013 range. The days indicator is at 19, down just barely from 20 because the bond market was closed on Veterans Day. High readings like this were a rarity during past QE implementations, but have been the norm so far this year. We estimate net inflows this past week to have been about \$13.1 billion, a very low number for 2013. This was largely thanks to the Thanksgiving holiday, but it could provide the bears an opportunity over the next few days.

This upcoming week will be very strong, though. The December schedule was released on Friday and I have produced the projected QE Buying Power Index numbers in the chart below.



This upcoming week is set to see the biggest flows of the month, which should help support the market as we near the end of the week and some the following week. The 3rd week of the month will also see strong flows. But unlike other months, there will be no POMO buying after the 23rd. The week between Christmas and New Years has been a seasonal strong period, so perhaps it will hold up just fine, but early January could see a pullback with the lack of flows at the end of the year.

I'm optimistic about the intermediate-term. Liquidity flows are currently strong, and certainly have been a positive for a while now. Trend and momentum measures are also favoring more upside. Additionally, the Nasdaq is back in a leading position. But the breadth divergences noted by the QE Study of Tops remain in place. I have moved my outlook up to "bullish" from "somewhat bullish". While we could see a dip early in the month, I expect the combination of bullish forces and typically strong December seasonality will make for a solid finish to 2013. 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.

XIV – buy ½ position @ \$32.78 LIMIT. The short-term outlook is suggesting a market bounce. Additionally, VIX jumped up on Friday and closed at a 15-day high (so it could be nearing a reversion downwards). Also, contango between the front month and the 2nd month VIX futures is still strong at 8.6%. Strong contango, a stretched VIX, and a bullish short-term market outlook are 3 conditions that I like to see when considering an XIV trade. They are all in place currently, so I'll begin to scale into a long XIV position. Subscribers should note that these positions can be extremely volatile. For those that would like more information on trading XIV, I encourage you to watch the 3 related webinars (for gold subscribers) on the Videos page of the website.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	11/29/2013	\$180.95	\$180.95	0.00%		bought at close

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