

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 9, 2013

Volume 6 Issue 237

## Market Overview



## Signals Overview

| Aggregator | Aggressive VIX | QE Buy Pwr Swing | NDX Trend Timer |
|------------|----------------|------------------|-----------------|
| Flat       | 50% Long XIV   | Flat             | Flat            |

## Tonight's Research Points

- Low-volume bounces when the SPX has been extremely oversold short-term have suggested an upside edge.

## *Short-term Outlook*

### *The Bottom Line*

After a buildup of bullish evidence the past few days the market enjoyed a strong bounce on Friday. So far the bounce looks good, but the market has already turned short-term overbought. I'm looking to scale back on my long exposure and use the bounce to take some profits.

**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> |                                     |             |         |              |
| December 9, 2013           | Low vol bounce from oversold        | 1-5 days    | Bullish | 1.90%        |
| December 6, 2013           | 4+ days dn. Today big drop. > 200ma | 1-3 days    | Bullish | 1.90%        |
| December 5, 2013           | VIX up 7 days                       | 1-3 days    | Bullish | 2.10%        |
| December 4, 2013           | 3 down from 50-high < 10ma > 10-low | 1-4 days    | Bullish | 1.75%        |
| December 4, 2013           | System 11111                        | 1-4 days    | Bullish |              |
| <b>Active - Long Term</b>  |                                     |             |         |              |
| December 2, 2013           | Nasdaq leading SPX                  | int term    | 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 |              |
| <b>Dropped Tonight</b>     |                                     |             |         |              |
| December 6, 2013           | QE Buying Power System              | 1-6 days    | Bullish |              |

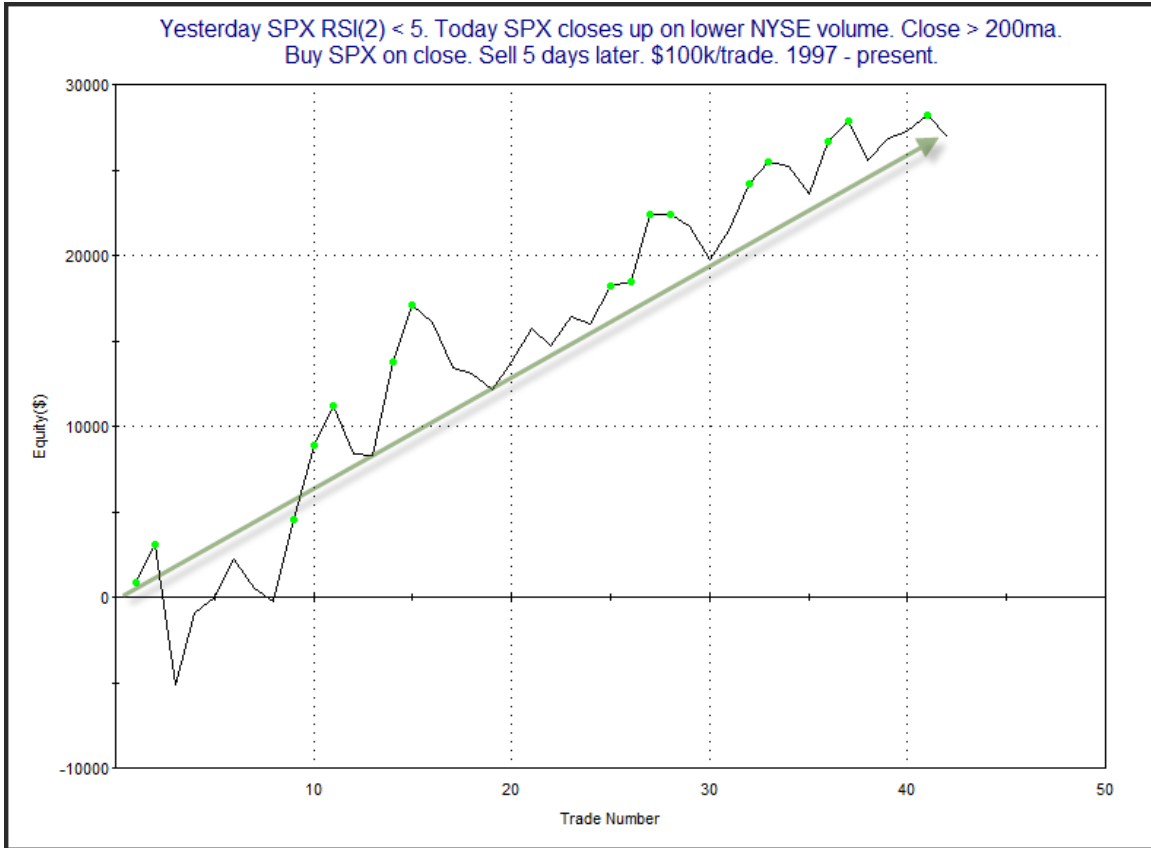
**The Evidence**

After 5 down days the market put in a sizable bounce on Friday. The SPX rose 1.1%, the Nasdaq rallied 0.7%, and the Russell 2000 gained 0.8%. Breadth was squarely positive as the NYSE Up Issues % was 72% and the Up Volume % was 67%. Total NYSE volume fell some from the level of the last few days.

The fact that volume came in lower on the bounce than it did during the previous day's selling is sometimes pointed to as a negative. This is a misnomer. The lower volume is often a good thing. This can be seen in the studies below that look at bounces from strongly oversold short-term conditions. To measure short-term oversold in this case a 2-period RSI calculation is used. These studies were last seen in the 5/12/11 Letter. This first one examines bounces on declining volume, similar to Friday.

| Yesterday SPX RSI(2) < 5. Today SPX closes up on lower NYSE volume. Close > 200ma. Buy SPX 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 |
| 5   | 26,895.94       | 42                | 25                  | 17                 | 59.52             | 2,196.13               | 5,396.71               | -1,647.49             | -8,178.56             | 1.33                | 1.96              | 640.38         |
| 4   | 26,831.54       | 44                | 28                  | 16                 | 63.64             | 1,739.95               | 4,223.34               | -1,367.95             | -2,736.28             | 1.27                | 2.23              | 609.81         |
| 3   | 17,220.01       | 45                | 26                  | 19                 | 57.78             | 1,420.06               | 4,457.43               | -1,036.93             | -3,490.90             | 1.37                | 1.87              | 382.67         |
| 2   | 21,806.22       | 45                | 30                  | 15                 | 66.67             | 1,283.38               | 4,001.40               | -1,113.02             | -2,735.64             | 1.15                | 2.31              | 484.58         |
| 1   | 12,846.23       | 45                | 27                  | 18                 | 60.00             | 943.26                 | 2,842.84               | -701.21               | -2,782.56             | 1.35                | 2.02              | 285.47         |
| <b>88% of instances posted a close above the entry price at some point in the next week.</b>  |                 |                   |                     |                    |                   |                        |                        |                       |                       |                     |                   |                |

The numbers here are all fairly impressive. The profit curve for the 5-day holding period was the most attractive. I have posted it below.



This curve is appealing. Definitely choppy, but continually upsloping.

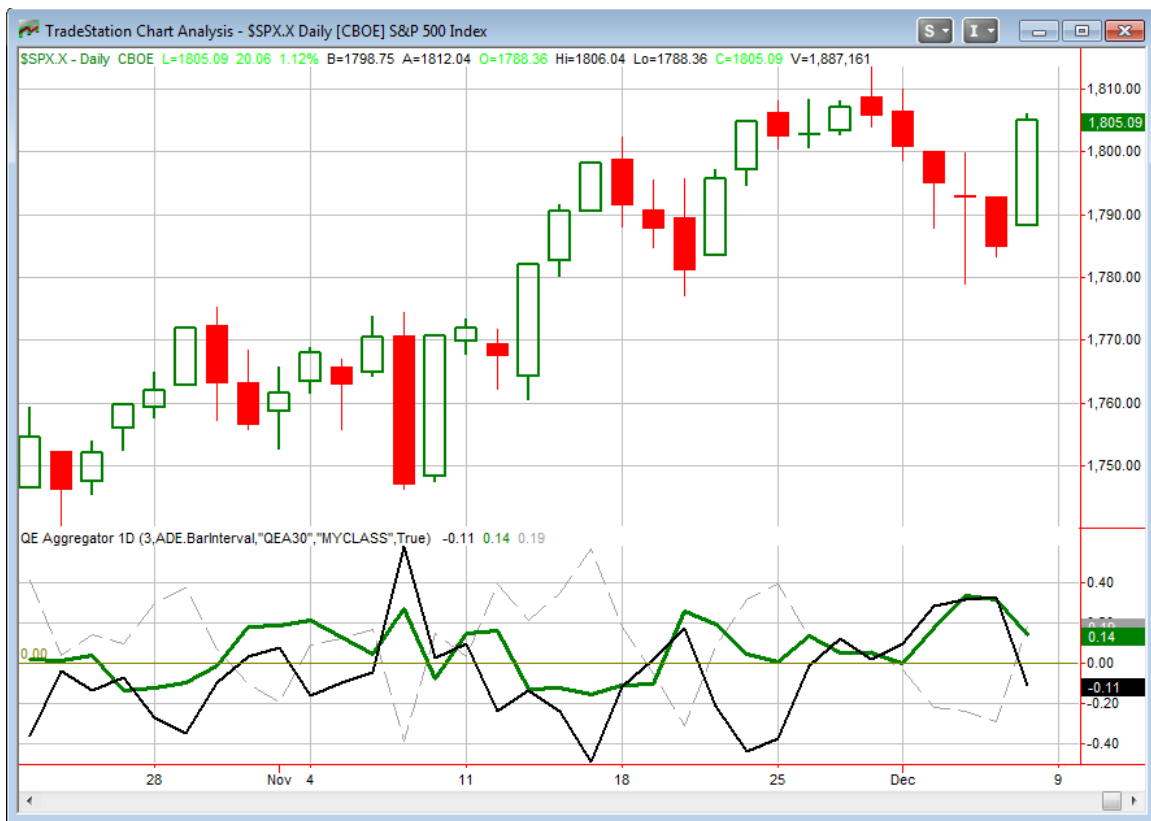
The next test looks at the exact same scenario, except rather than requiring volume come in lower, it requires it to come in higher.

Yesterday SPX RSI(2) < 5. Today SPX closes up on **higher** NYSE volume. Close > 200ma.  
Buy SPX 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 |
|--------|-----------------|-------------------|---------------------|--------------------|-------------------|------------------------|------------------------|-----------------------|-----------------------|---------------------|-------------------|----------------|
| 5      | 2,086.93        | 22                | 12                  | 10                 | 54.55             | 1,353.20               | 3,532.25               | -1,415.14             | -2,969.64             | 0.96                | 1.15              | 94.86          |
| 4      | 324.36          | 23                | 14                  | 9                  | 60.87             | 1,053.42               | 2,587.95               | -1,602.61             | -2,541.13             | 0.66                | 1.02              | 14.10          |
| 3      | -5,355.93       | 23                | 9                   | 14                 | 39.13             | 1,419.25               | 3,939.79               | -1,294.94             | -2,517.13             | 1.10                | 0.70              | -232.87        |
| 2      | -4,140.89       | 24                | 11                  | 13                 | 45.83             | 900.38                 | 2,794.56               | -1,080.39             | -1,962.36             | 0.83                | 0.71              | -172.54        |
| 1      | -3,399.31       | 24                | 10                  | 14                 | 41.67             | 633.49                 | 2,536.10               | -695.30               | -1,774.60             | 0.91                | 0.65              | -141.64        |

As you can see, the change in volume appears to have a dramatic impact on the results. It would seem that the low volume bounces may suggest that people need convincing and are not rushing back in. But over the next few days, their willingness to commit capital and desire not let the bounce get too far away from them helps to propel it further.

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



Tonight's bullish study helped the green Aggregator Line remain well above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the rally caused the black Differential Line to drop down below 0. The negative Differential Line reading means the SPX is overbought versus recent expectations. So expectations are positive but the SPX is already short-term overbought. 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 signal to change from long to flat.

With the current active studies, expectations are set to remain bullish on Monday. This could change if new bearish evidence emerges. The Differential Pivot will be 1801.99 on Monday. That is just 0.2% below Friday's close. So it won't take much of a decline to move back to "oversold" versus recent expectations.

The bounce looks pretty good so far, with no real red flags, but the SPX has quickly become overbought, which can limit upside opportunity. I plan to take off some of my index position as early as the open if the market does not suffer a gap down. A lower close will likely turn the SPX back to oversold, so I will hold the 2<sup>nd</sup> lot at least until the close. If it closes up (or down just slightly) then I will exit the 2<sup>nd</sup> lot as well. A down close (of more than just a little) and I will hold it in anticipation of the Aggregator signal again turning bullish.

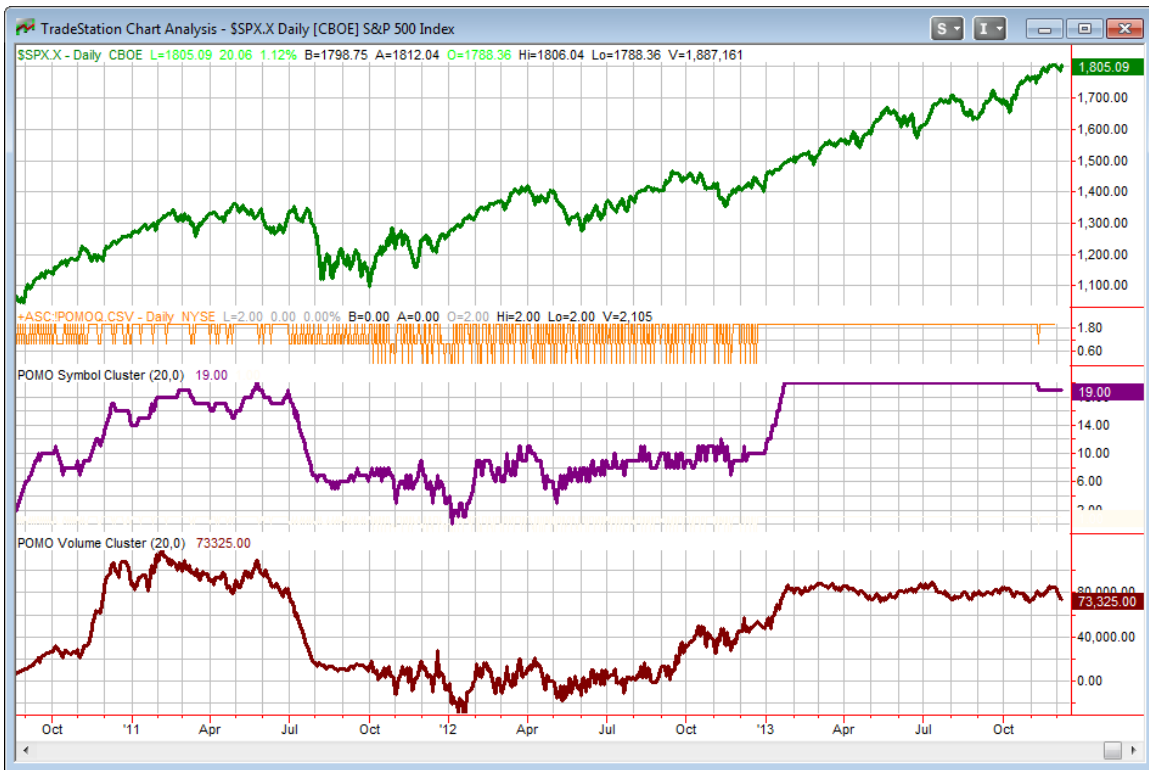
***Intermediate-term Outlook (2 weeks – 2 months) – updated 12/9 – bullish***

After 8 weeks up in a row, the SPX suffered its first down week. But it was down very much. Friday's rally was strong and the net loss in the SPX for the week was less than 1 point. While we won't know for sure until a new high is made, the uptrend certainly seems intact at the present.

From an intermediate-term standpoint there were no new studies that emerged, and really nothing substantial changed among our intermediate-term 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 dipped a little as a huge week came off the back end of the 20-day reading. 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 \$25.6 billion, a strong number, even for 2013. This was likely a help at the end of the week and could provide further fuel into next week.

This upcoming week will see milder liquidity flow, with an estimated \$18.8 billion of Fed buying expected. This is a little below average, but still a decent sized number that should continue to provide some fuel to the market.

Overall, I'm still 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, and the Nasdaq is in a leading position. But the breadth divergences noted by the QE Study of Tops remain in place. I remain bullish and 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***

*ABT @ \$36.92 (buy 1/3 at limit) (not filled – cancel for now)*

### ***Catapult for ETF's Trades***

*None*

### ***Broad Market Large Cap CBI – 1 (ABT)***

## **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**

| <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>                   |
|-------------------|-------------------------|-----------------------|-----------------------|---------------------|-------------|--------------------------------|
| SPY(1/4)          | 11/29/2013              | \$180.95              | \$180.94              | -0.01%              |             | sell @ \$181.00 limit          |
| XIV(1/2)          | 12/2/2013               | \$32.78               | \$32.88               | 0.31%               |             | Aggressive XIV                 |
| <b><i>TWX</i></b> | <b><i>12/3/2013</i></b> | <b><i>\$65.46</i></b> | <b><i>\$66.57</i></b> | <b><i>1.70%</i></b> |             | <b><i>sold on close</i></b>    |
| SPY(1/4)          | 12/4/2013               | \$179.10              | \$180.94              | 1.03%               |             | sell @ \$180.60 limit on close |

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