

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 21, 2014

Volume 7 Issue 13

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing
Flat	50% Long XIV	Flat

Tonight's Research Points

- MLK week has historically gone to the bears.
- SPX made another new high this past week but the % of stocks making new highs is still diverging badly.

Short-term Outlook

The Bottom Line

Both expectations and overbought/oversold readings are very close to neutral. There does not appear to be a strong directional edge yet. I will give it another day before considering new exposure.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active - Short Term				
January 21, 2014	MLK week bearish	1-4 days	Bearish	-1.90%
January 17, 2014	SPX down. Up Issues % > 55%. SPX>200	1-3 days	Bullish	1.10%
January 16, 2014	SPY 2 unfilled up gaps & 50-high	1-3 days	Bullish	
January 14, 2014	1% drop bad breadth	1-9 days	Bullish	3.10%
Active - Long Term				
December 23, 2014	QE Tapering	int term	Neutral	
December 18, 2013	4 Hindenburg Triggers	1 - 35 days	Bearish	-7.00%
December 2, 2013	Nasdaq leading SPX	int term	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	
February 1, 2012	Golden Cross	int term	Bullish	
Dropped Tonight				
January 13, 2014	Jan opex week bearish	1-5 days	Bearish	-2.30%

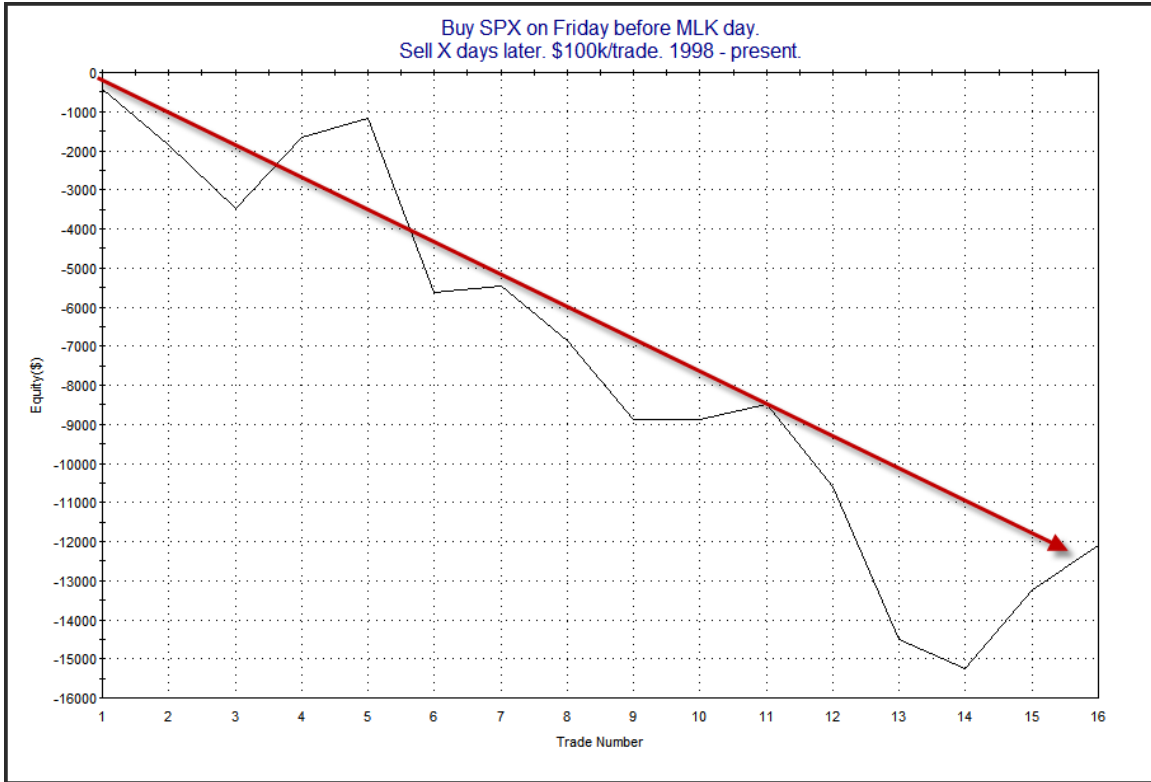
The Evidence

Some afternoon selling led to a down day on Friday. The SPX and the Russell 2000 declined 0.4% while the Nasdaq dropped 0.5%. Breadth was weak as the NYSE Up Issues % was 45% and the Up Volume % was 34%. Total NYSE volume spiked, largely thanks to options expiration.

Martin Luther King Jr. Day is on Monday. The NYSE has only observed MLK Day as a holiday since 1998. But over that 16 year period the market has not done too well during MLK week. I discussed this last year in the 1/22/13 Letter. I've updated that study below.

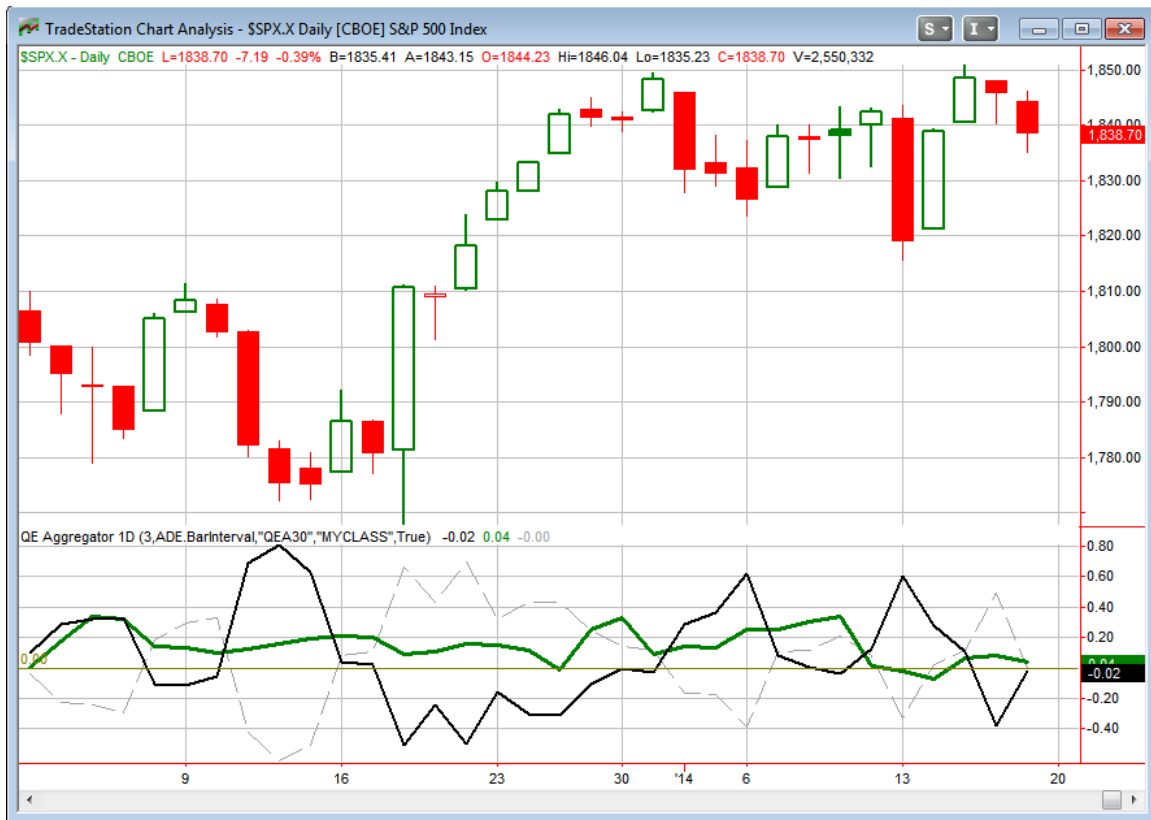
Buy SPX on Friday before MLK day. Sell X days later. \$100k/trade. 1998 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
4	-12,105.22	16	6	10	37.50	1,003.43	2,024.33	-1,812.58	-4,441.80	0.55	0.33	-756.58
3	-2,501.80	16	7	9	43.75	1,099.37	2,206.50	-1,133.04	-2,646.54	0.97	0.75	-156.36
2	837.49	16	10	6	62.50	682.32	1,459.15	-997.63	-2,576.20	0.68	1.14	52.34
1	-3,558.41	16	9	7	56.25	690.58	1,776.32	-1,396.24	-5,253.30	0.49	0.64	-222.40

Numbers here are fairly weak – especially Friday. Below is an equity curve showing how the full (4-day) week has played out over time.



MLK week has seen the market rise the last couple of years, but prior to that it had some real struggles. Maybe the downside tendency is fading, or maybe it was just a blip and the downward inclination will reassert itself. It's tough to tell at this point. I'm still inclined to view seasonality as favoring the bears this upcoming week. Of course we still have some short-term bullish studies active that are related to price action and breadth. So I'll use the Aggregator to help me set my bias.

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



Despite the seemingly bearish seasonality the green Aggregator Line held just barely 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 just barely below 0. The negative Differential Line reading means the SPX is overbought versus recent expectations. So expectations are positive but the SPX is overbought. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. And it does not get much more neutral than seeing both so close to 0. This caused the Aggregator signal to remain flat.

If the current open studies remain as-is then expectations would turn a little bearish on Tuesday. Of course this could change if more bullish evidence emerges. The Differential Pivot will be *inverted* at 1847.88 on Tuesday. That is *0.5% above* Friday's close. An inverted pivot means the Differential Line will cross through 0 if SPX closes flat. In this case SPX is going to need to rise at least 0.5% in order to remain "overbought". Anything less than that and it will turn oversold.

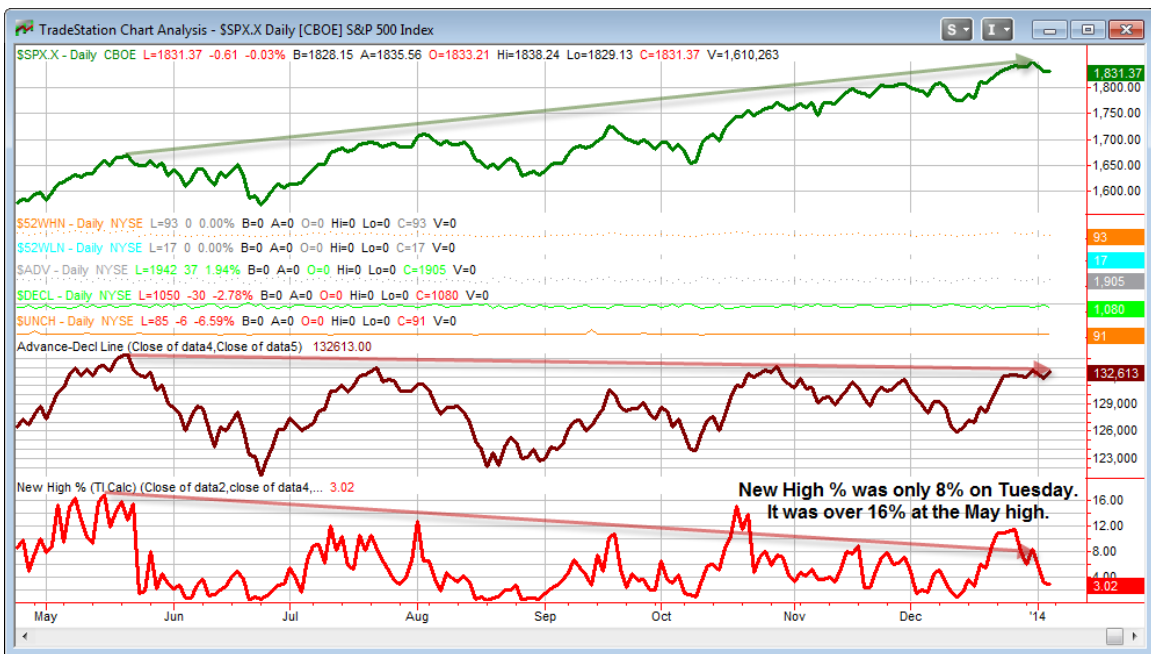
Evidence is fairly meek. Expectations are set to flip to slightly bearish, and the Differential Pivot is inverted. We basically have a lot of mild crosswinds blowing. It does not appear to be a favorable place to enter a new trade here. Things could change Tuesday if SPX closes down again. Three consecutive down days will often trigger some bullish studies, though not always. It really depends on how they unfold. But another

down day has the potential to generate some bullish studies. So I'll be watching closely on Tuesday to see how things are shaping up.

Intermediate-term Outlook (2 weeks – 2 months) – updated 1/13 – somewhat bullish

The SPX finished this week down slightly from last week, but it did manage to make a new high on Wednesday. So the uptrend certainly appears to be intact.

The bad news is that the NYSE New High % continues to diverge, as it has since July. This can be seen on the chart below, which I copied from the QE charts page.



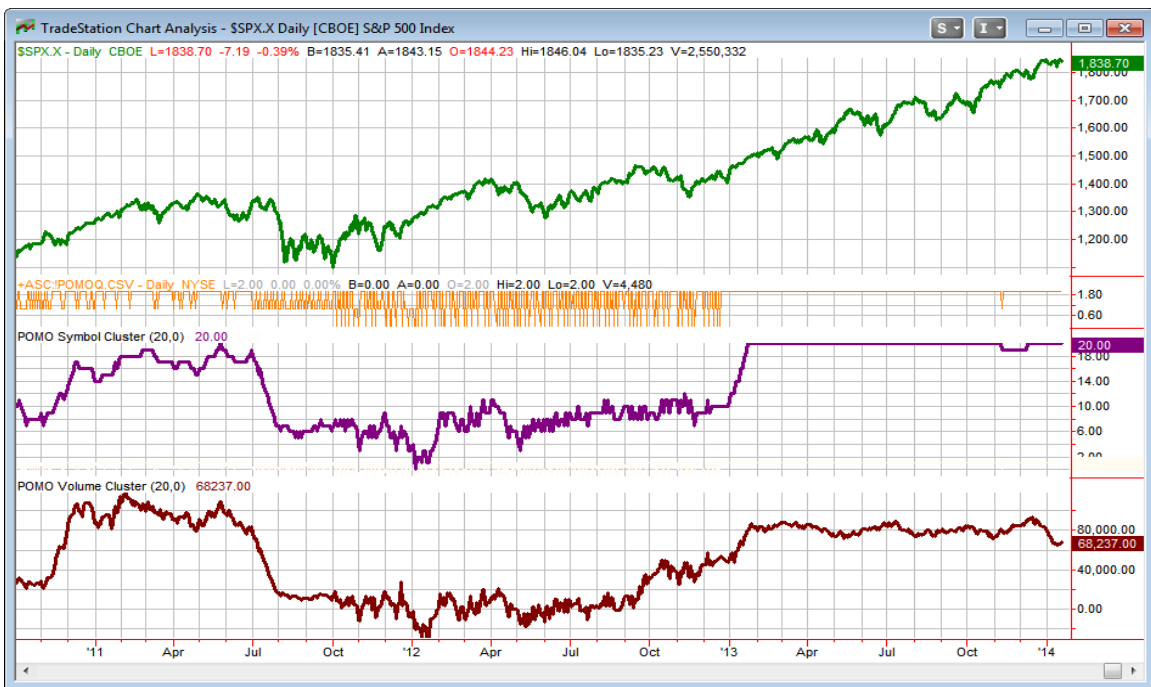
In fact, not only is the New High % diverging, it posted a number that was about 50% of the May level. That is a substantial difference. And as I discussed in the Study of Tops and have reiterated here a number of times, the divergent New High % is a condition that has preceded every major SPX decline since 1970.

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. The current divergence is about 8 months old. It hasn't mattered yet, but if it persists, then it will matter at some point.

If the market continues higher and the New High % rallies 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 it. For now it remains highly divergent. So the rally is occurring with fewer and fewer stocks participating. And from this point it will likely take quite a bit of work to get the New High % back to the May level.

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 days indicator is still riding along at 20, where it spent most of 2013. The volume indicator is starting to flatten out at its new, reduced level. We estimate net inflows this past week to have been about \$20 billion, which is high compared to the last couple of weeks. This should provide some fuel for the market in the days ahead.

This upcoming week there is about \$15 billion of inflows expected. This sounds a little low, but it is around “normal” for a 4-day week. It still appears to be a healthy amount of stimulus, and one that should serve to aid the continuing bull. But the more tapering the Fed does, the lower the red volume line is going to travel. The high correlation between Fed stimulus amounts and market performance over the years is undeniable. The lower the red line goes, the more substantial corrections I expect to see.

The next Fed policy announcement is scheduled for January 29th. We will see then whether they intend to continue to lessen the amount each meeting, or whether they intend to hold it at \$75 billion for a while longer.

The intermediate-term bullish studies are still outweighing the bearish ones. The breadth thrust from October, the leading Nasdaq, and the continued uptrend all favor the bulls. But the bears can point to the narrowing of new highs – both with the QE Study of Tops New High % indicator, and the Hindenburg Omen signals from December, as potential warning signs. Liquidity is likely still somewhat positive, but less so than before. Overall, I continue to lean bullish, but not strongly so. I will still favor longs over shorts. I will need very compelling evidence to consider a short position, and I will be a bit more discerning with long entries than if I was outright bullish.

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 [numbered systems 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. I'll wait another day. Aggressive traders could certainly consider some signals from the [Numbered Systems Page](#).

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
<i>AXP(1/3)</i>	<i>1/14/2013</i>	<i>\$86.99</i>	<i>\$89.375</i>	<i>2.74%</i>		<i>out 1/2@\$87.78 & 1/2@\$90.97</i>

The 2nd half of AXP was sold at the close as indicated would be done in Thursday night's Letter.

This report has been prepared by Hanna Capital Management, LLC and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy securities. While information contained herein is believed to be accurate at the time of publication, we make no representation as to the accuracy or completeness of any data, studies, or opinions expressed and it should not be relied upon as such. Robert Hanna, Hanna Capital Management, LLC or clients of Hanna Capital Management, LLC may have positions or other interests in securities (including derivatives) directly or indirectly which are the subject of this report. This report is provided solely for the information of Hanna Capital Management, LLC clients and prospects who are expected to make their own investment decisions without reliance upon this report. Neither Hanna Capital Management, LLC nor any officer or employee of Hanna Capital Management, LLC accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report may not be reproduced, distributed or published by any recipient for any purpose without the prior express consent of Hanna Capital Management, LLC.

Copyright © 2014 Hanna Capital Management, LLC.