

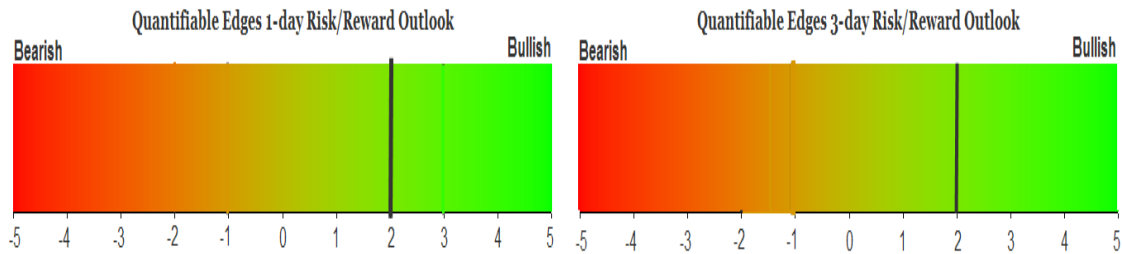
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 3, 2014

Volume 7 Issue 22

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing
Long	75% Long XIV	Long

Tonight's Research Points

- A pullback into turn of the month during times SPX has been above its 200ma has typically been followed by a bounce.
- The big gap down and partial reversal suggest more upside in the coming days.
- The January Barometer shows that years with a poor January have been inconsistent the remainder of the year.
- Fed liquidity flows are shrinking, which I view as a potential intermediate-term negative.

Short-term Outlook

The Bottom Line

More evidence emerged on Friday suggesting a bounce. It is only moderately oversold at this point and has struggled to put together 2 good days lately. Still, it appears the early part of this week looks to favor the bulls, and I am currently positioned to take advantage of a bounce.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active - Short Term				
February 3, 2014	End of Month < 10ma and > 200ma	1-5 days	Bullish	2.20%
February 3, 2014	Gap dn 1% partial reverse < 10ma	1-2 days	Bullish	
January 31, 2014	20-low then sideways chop	1-5 days	Bullish	
January 30, 2014	20-low on a Fed Day	1-5 days	Bullish	2.10%
January 27, 2014	2 unfilled gaps dn > 200ma	1-6 days	Bullish	
January 27, 2014	Friday down 1.5x 20-day ATR	1-6 days	Bullish	
Active - Long Term				
January 27, 2014	2 unfilled dn gaps & 5-low > 200	1-10 days	Bullish	
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 31, 2014	Gap-n-Go from 50-low	1 day	Bearish	
January 30, 2014	Unfilled gap down after unfilled gap up	1-2 days	Bearish	
January 28, 2014	3rd dn Turnaround Tuesday	1-4 days	Bullish	2.10%

The Evidence

The market has had strong moves back and forth the last few days and Friday was the bears turn. The SPX fell 0.7%, the Nasdaq dropped 0.5% and the Russell 2000 finished down 0.7%. Breadth was weak as the NYSE Up Issues % came in at 38% and the Up Volume % was 27%. Total NYSE volume rose some from Thursday's level.

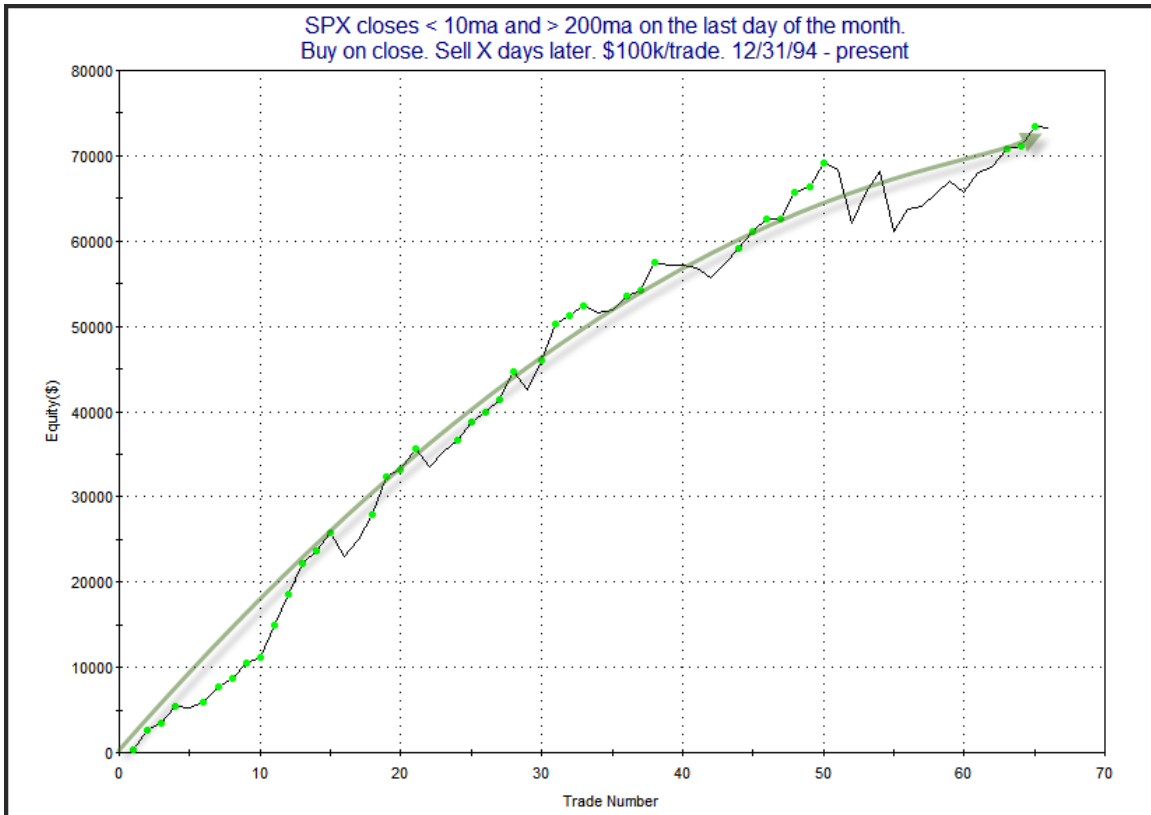
A few studies related to turn of the month triggered in the Quantifinder. Beginnings of new months often arrive with seasonal strength. This has especially been true during long-term uptrends when the market is not overbought. The study below was last seen in the 8/1/13 subscriber letter. It uses moving averages to take these concepts into account. All stats are updated.

SPX closes < 10ma and > 200ma on the last day of the month.
Buy on close. Sell X days later. \$100k/trade. 12/31/94 - 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	73,189.02	66	53	13	80.30	1,865.27	4,435.97	-1,974.64	-7,153.30	0.94	3.85	1,108.92
4	66,510.73	66	53	13	80.30	1,656.63	3,838.00	-1,637.75	-7,100.17	1.01	4.12	1,007.74
3	48,294.50	66	46	20	69.70	1,627.33	3,709.44	-1,328.13	-3,492.36	1.23	2.82	731.73
2	40,429.86	66	50	16	75.76	1,218.97	3,442.32	-1,282.41	-4,320.06	0.95	2.97	612.57
1	42,107.00	66	52	14	78.79	969.02	3,119.10	-591.56	-2,559.62	1.64	6.08	637.98

61 of 66 instances (92%) closed above the entry price at some point in the next 5 days.

Day 1 has obviously provided strong numbers, but even beyond that there appears to be some follow through over the next few days. Below is a profit curve for the 5-day holding period.



There have been a couple of big drops among recent instances, but 9 of the last 11 triggers have led to higher prices, so this edge appears to be intact.

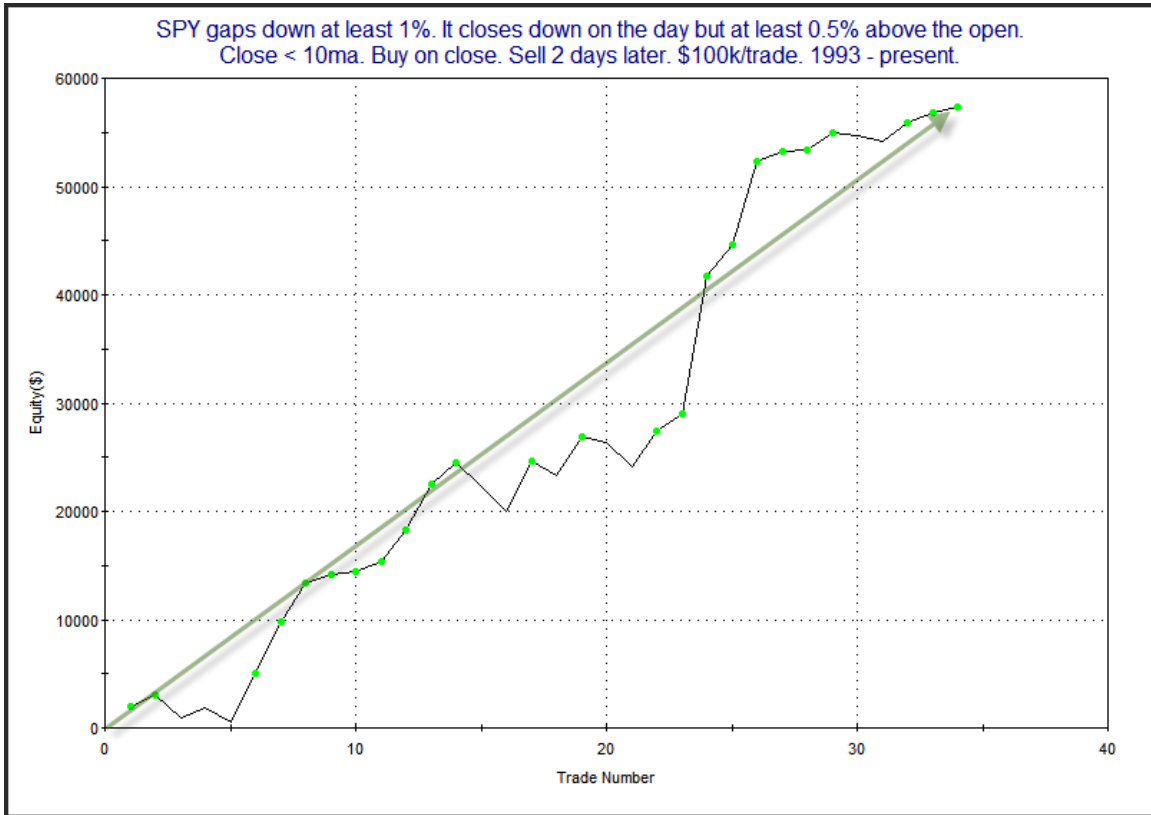
There were a couple of interesting studies that appeared in the Quantifinder related to big gaps down and partial reversals. The one below, from the 5/24/13 letter, I found to be the most compelling. I have updated the study below.

**SPY gaps down at least 1%. It closes down on the day but at least 0.5% above the open.
Close < 10ma. Buy on close. Sell X days later. \$100k/trade. 1993 - present.**

X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Max Winning Trade	All: Max Losing Trade	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	41,823.43	32	19	13	59.38	11,238.92	-6,614.24	3,728.40	-2,232.01	1.67	2.44	1,306.98
4	45,845.66	33	21	12	63.64	10,630.48	-6,725.16	3,245.35	-1,858.88	1.75	3.06	1,389.26
3	33,623.87	34	21	13	61.76	6,933.92	-5,355.22	2,594.37	-1,604.46	1.62	2.61	988.94
2	57,399.56	34	25	9	73.53	12,814.15	-2,251.30	2,815.58	-1,443.32	1.95	5.42	1,688.22
1	37,340.48	34	21	13	61.76	14,507.65	-3,576.07	2,636.57	-1,386.73	1.90	3.07	1,098.25

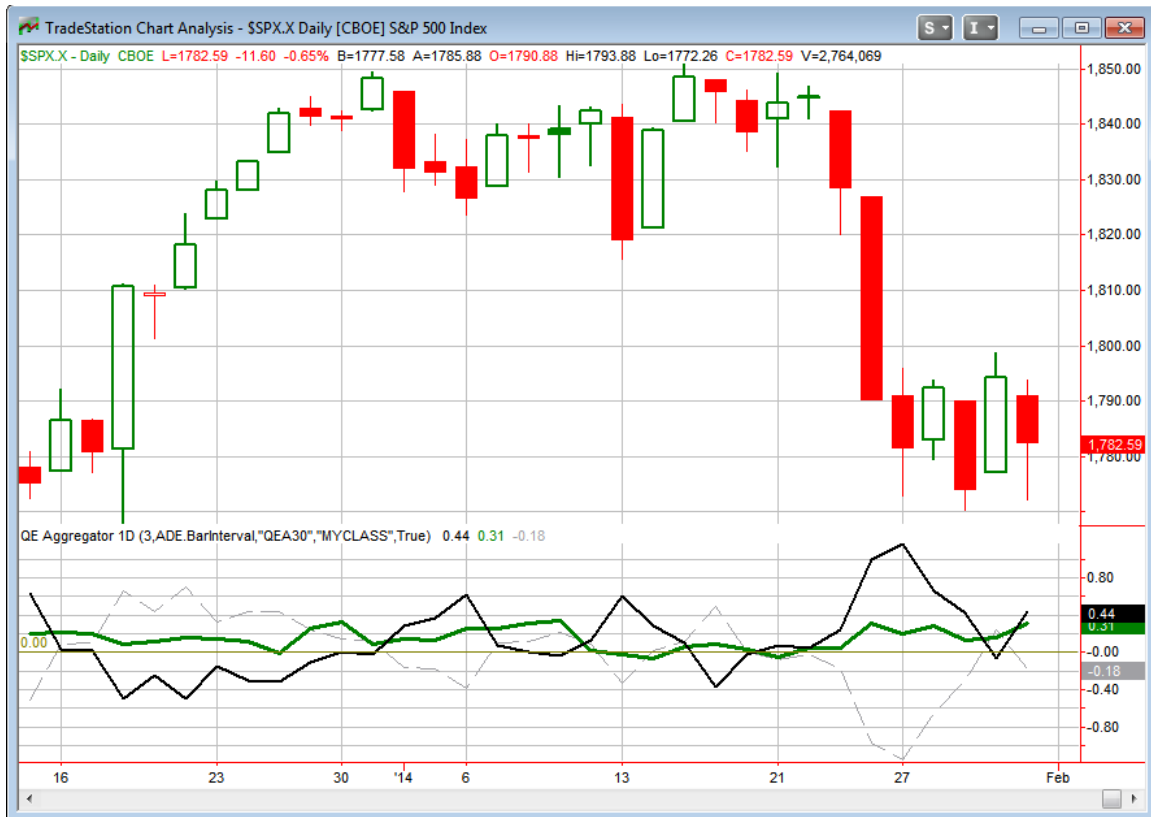
88% of instances closed above the entry price at some point in the next 5 days.

Some powerful bounces occurred over the next few days. Below is an equity curve to see how this setup has played out over time.



A little choppy, but the persistently higher profit levels are impressive. This study certainly seems worth inclusion on the Active List.

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



The mix of studies tonight left the green Aggregator Line again above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. We also saw the black Differential Line rise back above 0. The positive Differential Line reading means the SPX is now oversold versus recent expectations. So expectations are positive and the SPX is 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 turn long.

Based on the current open studies, expectations are slated to remain positive on Monday. This could change if strong bearish evidence emerges. The Differential Pivot will be 1784.76 on Monday. So it will only take a small rise in SPX for it to move back to short-term “overbought” versus expectations.

Evidence is still pointing higher. I still have a partial long index position and I still like the long side. Since the Differential Pivot is so close by, I will likely exit part of my long position on Monday if SPX closes up strongly.

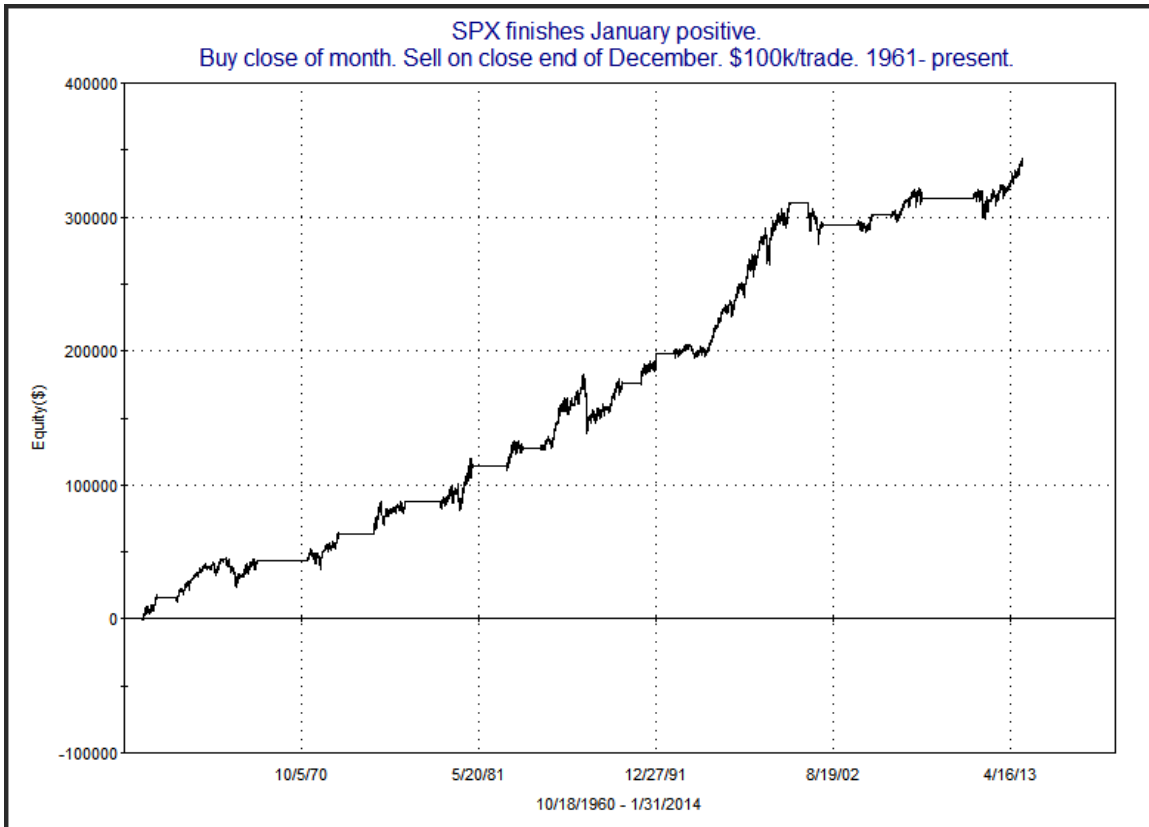
Intermediate-term Outlook (2 weeks – 2 months) – *updated 2/3 – neutral*

SPX fell a little further this past week, making it the 3rd weekly decline in a row. And while it remains above the 200ma, it did make new 50-day lows for the 1st time since 2012. So the trend now appears to be in some doubt.

The January Barometer is a fairly famous study from the Stock Traders Almanac. It says that “as goes January, so goes the year”. In other words, a positive January will typically lead to a positive year, while a negative January can be a warning. So, as I did in the 2/2/09 letter, let’s look at how the SPX has done for the remaining 11 months of the year based on how January performed.

SPX finishes January positive. Buy close of month. Sell on close end of December. \$100k/trade. 1961- present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$343,785.59	Profit Factor	8.46
Gross Profit	\$389,846.70	Gross Loss	(\$46,061.11)
Total Number of Trades	33	Percent Profitable	84.85%
Winning Trades	28	Losing Trades	5
Even Trades	0		
Avg. Trade Net Profit	\$10,417.75	Ratio Avg. Win:Avg. Loss	1.51
Avg. Winning Trade	\$13,923.10	Avg. Losing Trade	(\$9,212.22)
Largest Winning Trade	\$30,848.12	Largest Losing Trade	(\$15,908.89)

The numbers show that in years that January has done well, the rest of the year has typically fared well also. Below is a profit curve.

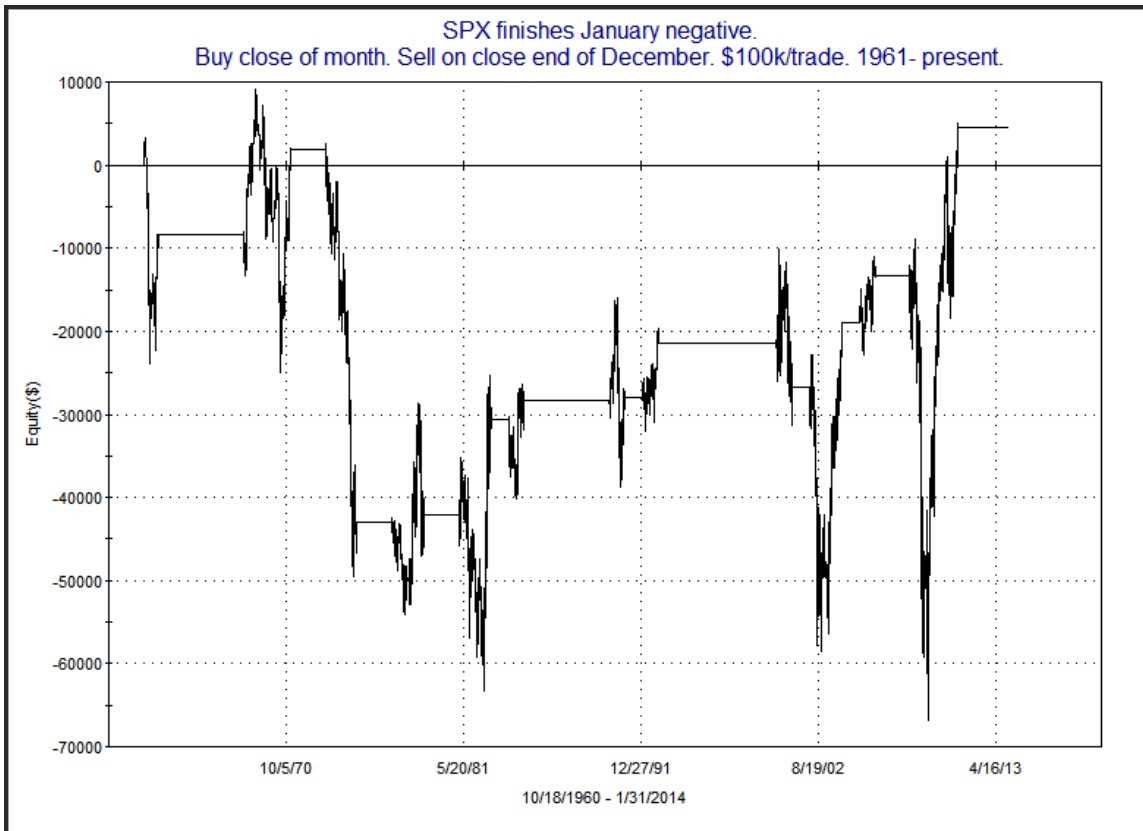


Now let's look at how Feb-Dec has done after a down January.

SPX finishes January negative.
Buy close of month. Sell on close end of December. \$100k/trade. 1961- present.

TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	\$4,518.65	Profit Factor	1.03
Gross Profit	\$142,088.95	Gross Loss	(\$137,570.30)
Total Number of Trades	20	Percent Profitable	55.00%
Winning Trades	11	Losing Trades	9
Even Trades	0		
Avg. Trade Net Profit	\$225.93	Ratio Avg. Win:Avg. Loss	0.85
Avg. Winning Trade	\$12,917.18	Avg. Losing Trade	(\$15,285.59)
Largest Winning Trade	\$34,995.62	Largest Losing Trade	(\$34,208.64)

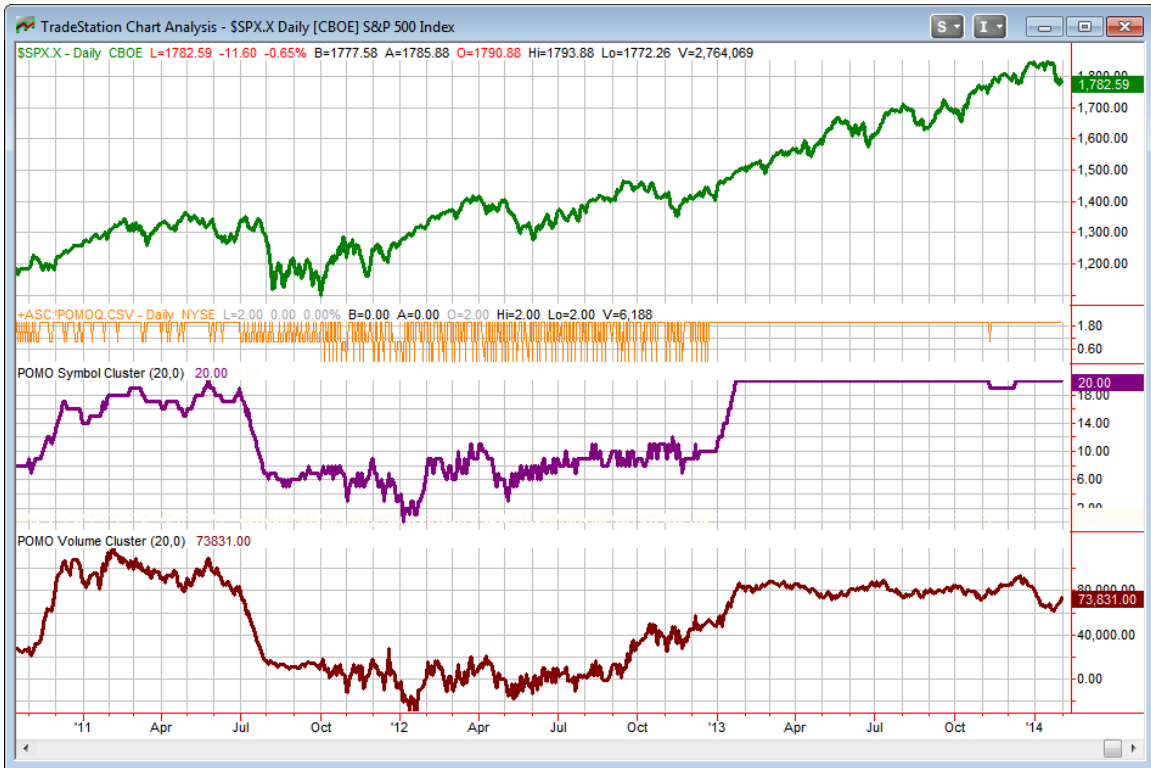
Not as many instances, but there does not appear to be the same kind of bullish tendency here. More of a crapshoot. Below is a curve.



Certainly not a chart to trade off of. So it would have been nice if January finished positive. But it is not a sign of impending doom. Just that we don't have the kind of momentum that would be preferable.

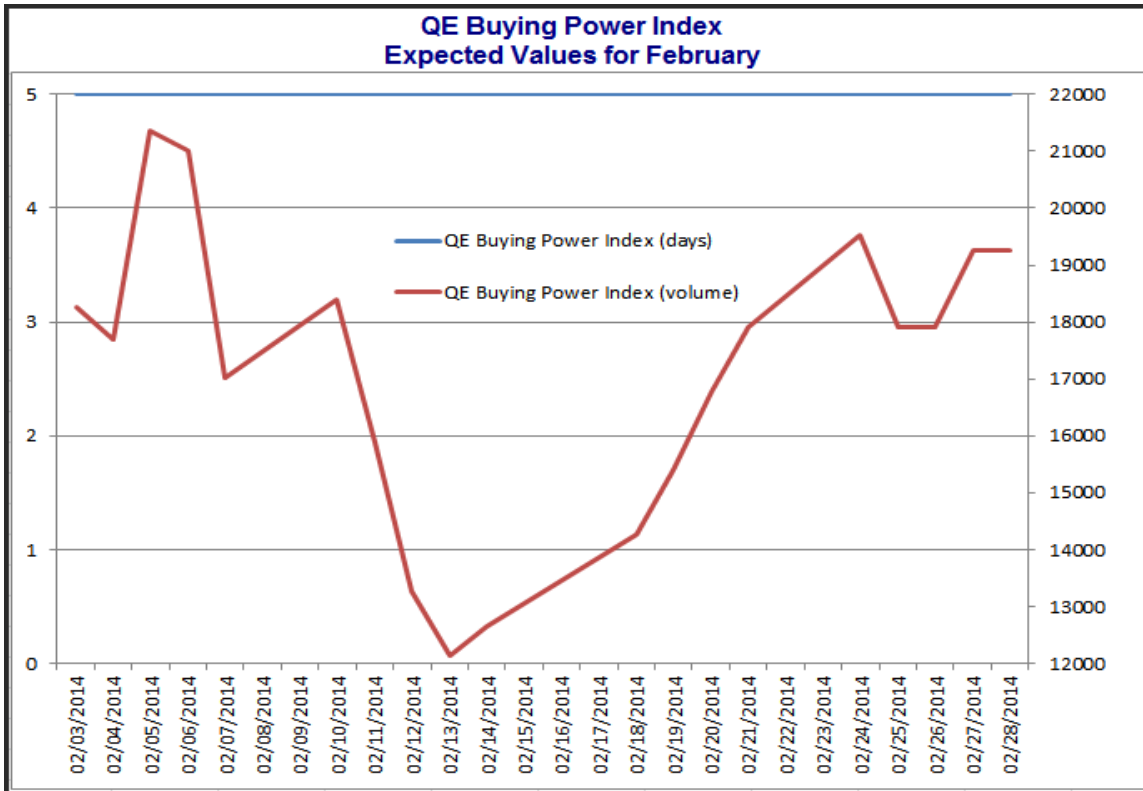
I update the intermediate-term POMO/QE chart each week. For those not familiar, below is a brief description.

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 rose a little this past week, but that is going to turn down and make new lows soon. We estimate net inflows this past week to have been about \$18.5 billion, which is towards the high end of what we are likely to see for a while.

This upcoming week there is about \$17 billion of inflows expected. This will be near the high end for February. With the release of the February schedule I have produced the QE Projected Values Chart for February.



The most substantial flows are occurring early in the month, with a real dip occurring the 2nd week of the month. If we see the bounce this week that the short-term outlook is showing is likely, then liquidity flows suggest the bears could have an opportunity to press for a retest or another leg down during the 2nd or 3rd week of February. This should be kept in mind as we move throughout the next few weeks.

The lowering of the scheduled Fed purchases to \$65 billion/month on Wednesday from \$75 billion suggests they are likely to continue tapering to lower and lower amounts – perhaps around \$10 billion/ Fed meeting. As far as the market is concerned I view this as a potential negative. Strong liquidity has fueled the rally over the last few years (and really every rally since at least 2003 when POMO flow data became available). Times when there has been limited or negative POMO flows have coincided with struggles for the market. While \$65 billion/ month still seems like a lot, it is dropping fast from the \$85 billion level that the market was accustomed to throughout all of 2013. Somewhere between \$85 billion and \$0 is likely a market negative. I don't know whether \$65 billion is still enough to provide a substantial fuel for a bull market. But at this point I am viewing it as neutral.

At this point I am lowering my entire outlook to neutral. I'm seeing fewer reasons to favor the long side and am becoming more willing to play both directions with short-term trades. There are still reasons to be optimistic of course. The breadth thrust from October, the leading Nasdaq, and fact that the market remains above it 200ma 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. And with liquidity now more sketchy, I'm not inclined to automatically give favor to the bulls. I may trade both sides at this point, with neither being particularly aggressive.

Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

Open Catapult Triggers

COF – 1/3 @ \$69.95(bought @ limit)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 1(COF)

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.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	1/27/2014	\$178.89	\$178.18	-0.40%		sell @ \$179.00 limit on close
SPY(1/4)	1/27/2014	\$178.01	\$178.18	0.10%		Aggregator
COF(1/3)	1/28/2014	\$69.95	\$70.61	0.94%		Catapult

I will look to exit 1 lot of SPY on a solid close higher.

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