

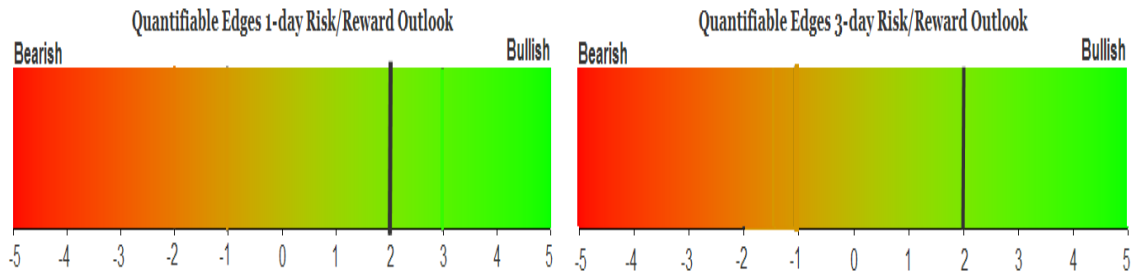
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 24, 2014

Volume 7 Issue 56

Market Overview



Signals Overview

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

Tonight's Research Points

- When SPX closes down but breadth is strong, it has often led to gains over the next few days.
- Solid gains during opex week are often reversed the following week.
- The Nasdaq is no longer leading the SPX – a condition in which the SPX has failed to make gains since 1971.

Short-term Outlook

The Bottom Line

Evidence is slightly bullish and the SPX is relatively oversold versus short-term expectations. But both of those things are scheduled to change on Monday. So while there may be a mild bullish edge I am not inclined to get involved with new positions just 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				
March 24, 2014	SPX up 1%-2% opex week	1-5 days	Bearish	
March 24, 2014	SPX dn. Up Issues > 55%	1-3 days	Bullish	
March 18, 2014	SPX up on lower vol after RSI2 < 5 yest	1-5 days	Bullish	1.20%
Active - Long Term				
March 14, 2014	QQQ 5 lower lows. Big drop today.	1-20 days	Bullish	11.90%
December 23, 2013	QE Tapering	int term	Neutral	
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish	
February 1, 2012	Golden Cross	int term	Bullish	
Dropped Tonight				
March 10, 2014	SPX 3-day high while Russell down 3	1-10 days	Bullish	4.50%
March 19, 2014	Low vol 20 2 days. >10 & > 200ma	1-2 days	Bearish	
December 2, 2013	Nasdaq leading SPX	int term	Bullish	

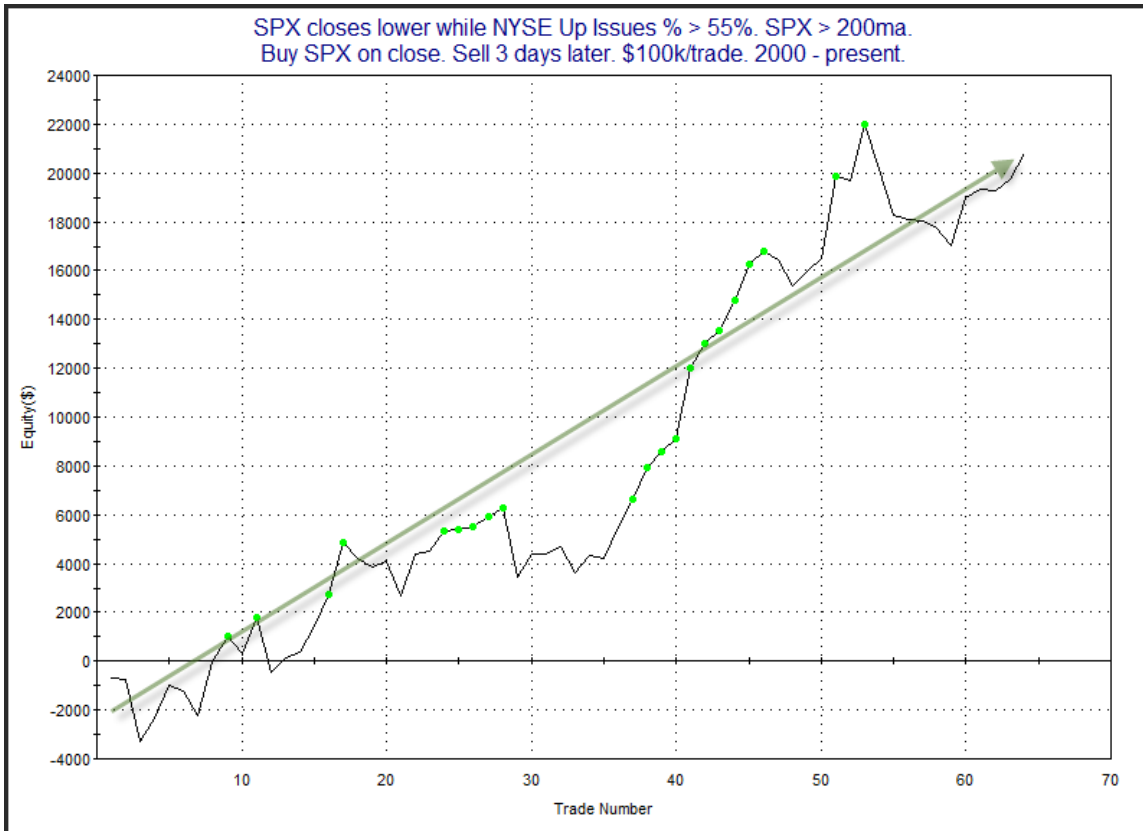
The Evidence

A strong open could not hold and the market finished Friday with some losses. The SPX lost 0.3%, the NASDAQ dropped 1.0% and the Russell 2000 fell 0.4%. Breadth was squarely positive as the NYSE Up Issues % came in at 59% and the Up Volume % was 51%. Total NYSE volume rose a little from Thursday's level.

The Up Issues % was unusually strong for a day that the SPX declined. The study below was last seen just last week in the 3/17/14 Letter. It looks at days like Friday where SPX declined despite strong breadth. Results are updated.

SPX closes lower while NYSE Up Issues % > 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	19,965.46	60	36	24	60.00	1,378.07	3,616.92	-1,235.21	-4,012.80	1.12	1.67	332.76	
4	20,577.29	62	37	25	59.68	1,300.38	3,429.00	-1,101.47	-2,921.28	1.18	1.75	331.89	
3	20,810.31	64	41	23	64.06	1,007.93	3,373.50	-891.95	-2,852.01	1.13	2.01	325.16	
2	19,195.51	65	44	21	67.69	829.21	3,025.12	-823.33	-3,119.03	1.01	2.11	295.32	
1	15,068.51	67	38	29	56.72	720.43	2,484.00	-424.41	-1,348.29	1.70	2.22	224.90	

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



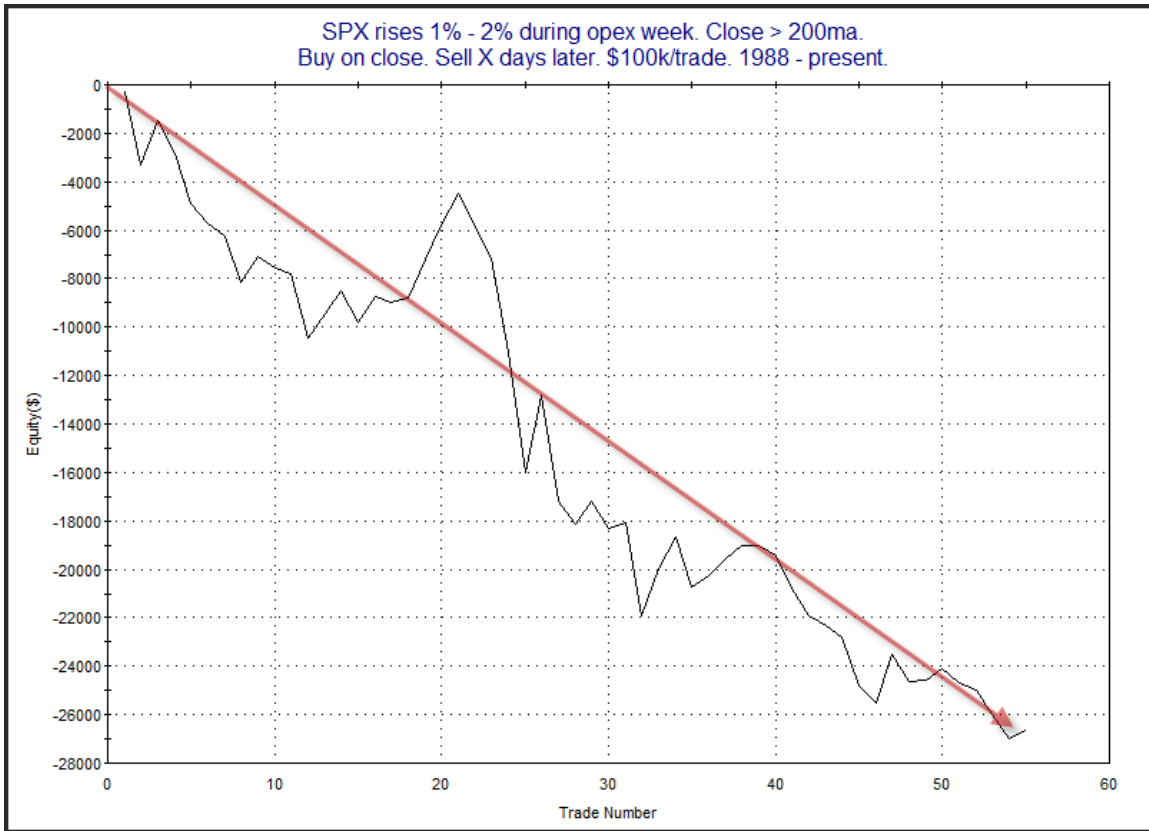
While the curve certainly appears choppy, it has persisted upwards. I believe this study is worth taking into consideration and I've included it among the active studies.

Strong moves on most opex weeks will often be followed by a pullback the following week. This is something we saw in the 11/18/13 subscriber letter. I have updated the study from that letter below.

SPX rises 1% - 2% during opex week. Close > 200ma.
Buy on close. Sell X days later. \$100k/trade. 1988 - present.

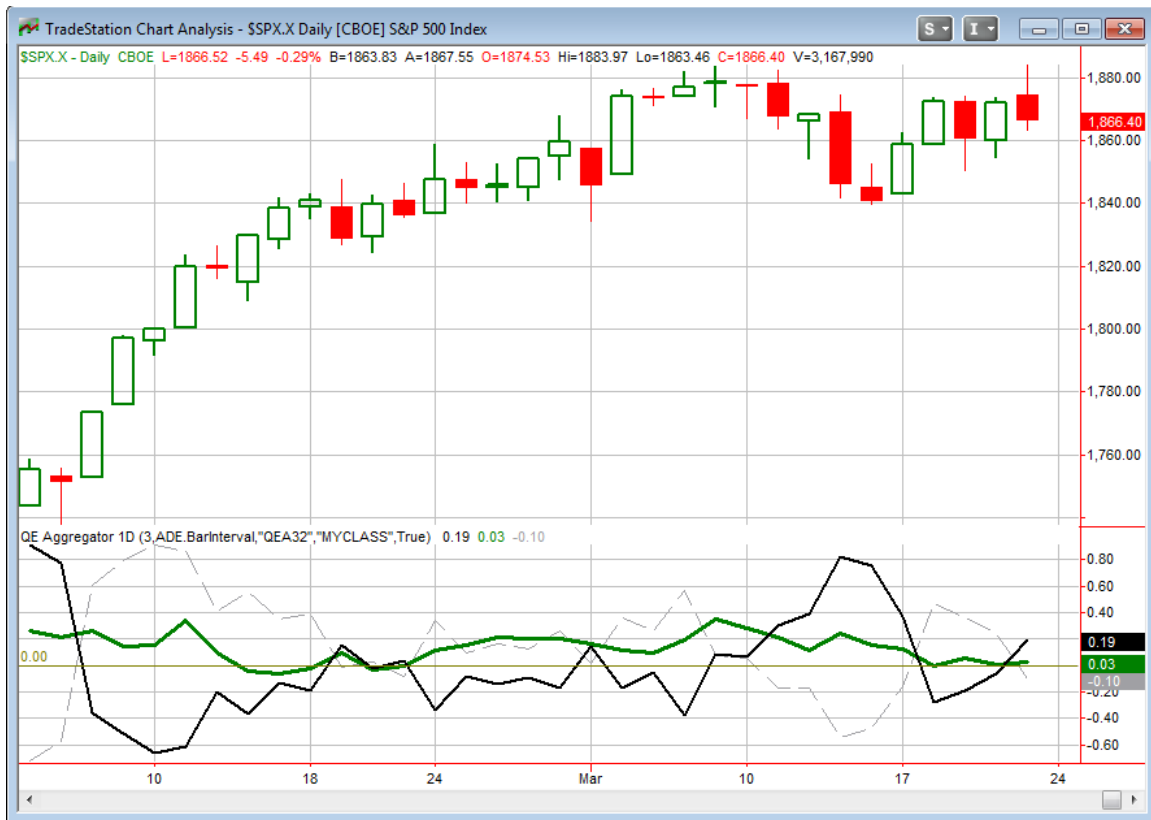
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-26,655.13	55	21	34	38.18	1,085.22	3,146.64	-1,454.26	-4,961.56	0.75	0.46	-484.64
4	-23,215.41	55	18	37	32.73	984.28	3,212.16	-1,106.28	-4,046.70	0.89	0.43	-422.10
3	-8,392.20	55	26	29	47.27	788.52	3,403.68	-996.33	-2,765.00	0.79	0.71	-152.59
2	-9,345.32	55	26	29	47.27	580.55	1,590.30	-842.75	-2,917.60	0.69	0.62	-169.91
1	-5,200.54	55	22	33	40.00	502.76	1,739.10	-492.77	-2,470.65	1.02	0.68	-94.56

The stats suggest a short-term downside edge. Below is a profit curve assuming a 5-day holding strategy.



There was definitely a bump for a few trades in the middle of the chart, but that was quickly righted. Overall the equity curve appears suitable enough to confirm the downside edge suggested by the stats table.

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



Tonight's mix of studies helped the green Aggregator Line remain slightly above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line rose above 0. The positive Differential Line reading means the SPX is 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. Therefore the Aggregator signal turned long at the close.

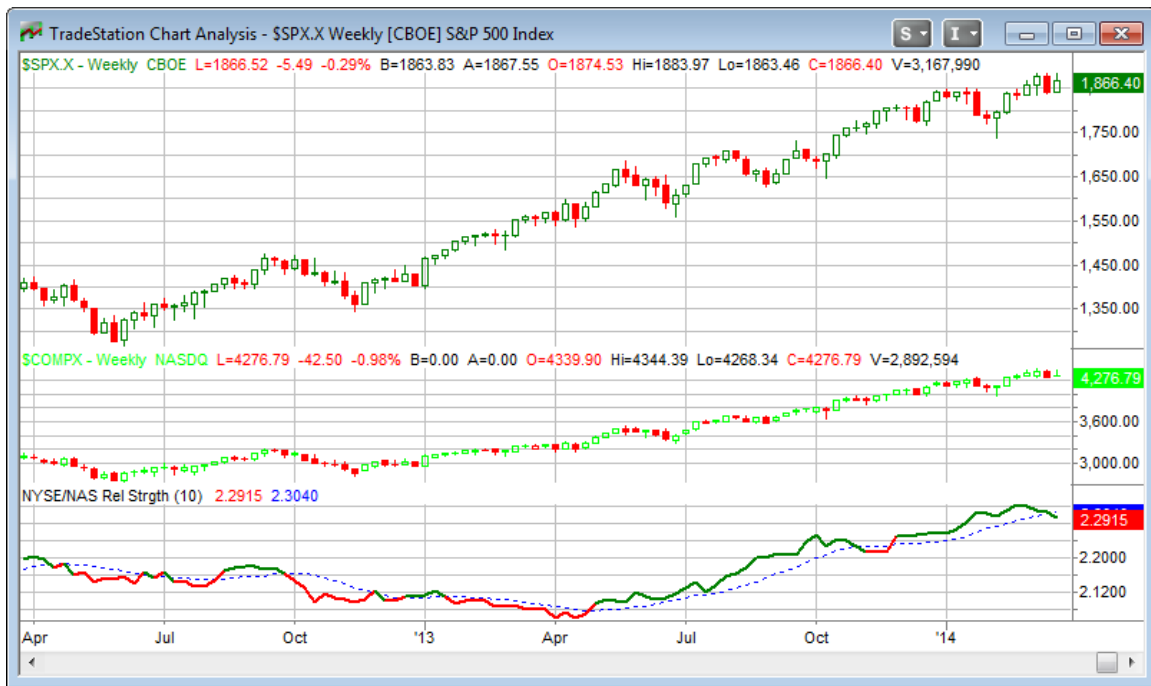
Based on the current active studies, expectations are slated to turn negative on Monday. Of course that could change if new bullish evidence emerges. The Differential Pivot will again be *inverted* at 1863.85 on Monday. That is 0.1% *below* Friday's close. An inverted pivot means the Differential Line will move through 0 if SPX closes flat. In this case SPX will need to close lower by at least 0.1% in order to remain oversold. Otherwise it will flip to "overbought" versus expectations.

Overall the Aggregator formation is bullish, but a flat close and no new studies would turn the formation bearish at the close on Monday. So the edge is not primed to last. And it is not terribly convincing. I'll be waiting for a better setup before putting new capital to work.

Intermediate-term Outlook (2 weeks – 2 months) – updated 3/24 – neutral

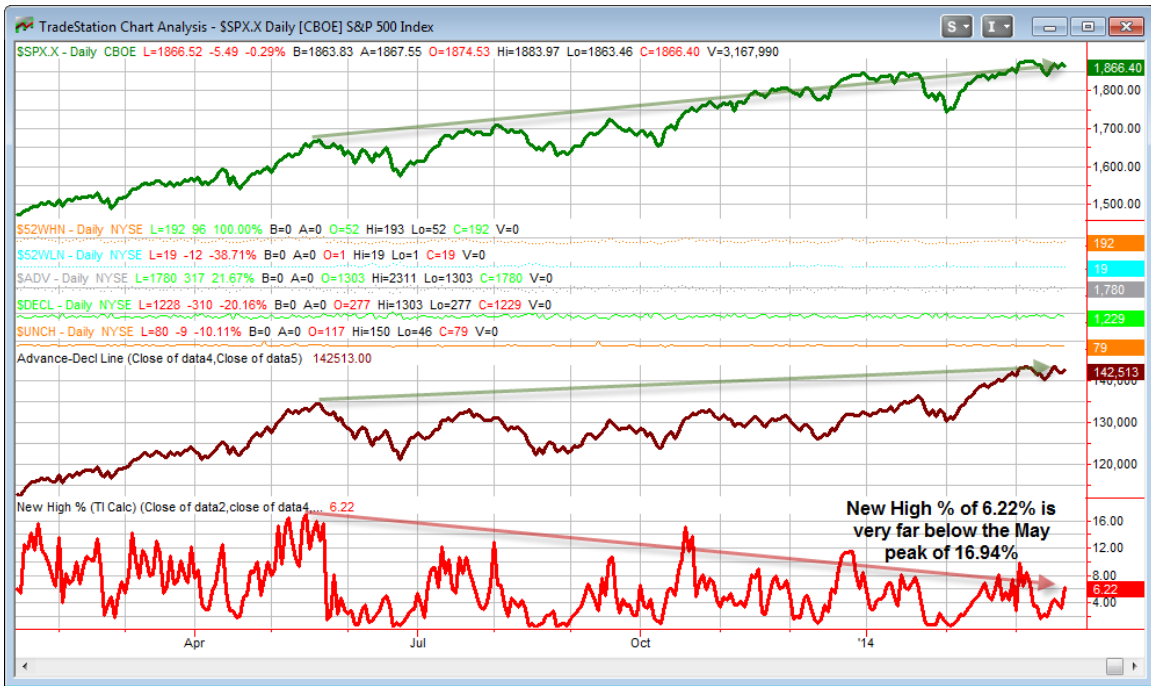
The market chopped quite a bit this week but finished up overall. And on Friday SPX hit a new intraday high before it turned down and closed lower on the day. So the uptrend is still in place, and it has paid to ride it for a long time now. But I am seeing some signs of weakening.

The action in the Nasdaq was a little discouraging for bulls. On Friday the Nasdaq/SPX lead/lag model turned back to neutral. This was caused by the relative weakness of the Nasdaq over the last few weeks, and it marks the first time since November that the Nasdaq has not been in a leading position. The chart below is the same as the one shown on the charts page and it shows the Nasdaq/SPX Lead/Lag indicator at the bottom of the chart.



Since 4/9/71, which is the earliest data point after the inception of the Nasdaq in which the calculations could be run, until now, the SPX has gained 1791.33 points when the Nasdaq was in leading position. When the SPX has been leading during that time it has gained only 33.09 points. More information on the indicator, including links to download the model in either Excel or Tradestation, can be found on [the Nasdaq Weekly Strength Model page](#).

Also a concern is that the NYSE New High % continues to diverge, as it has since July. This can be seen on the chart below, which is similar to the one found on the QE charts page.



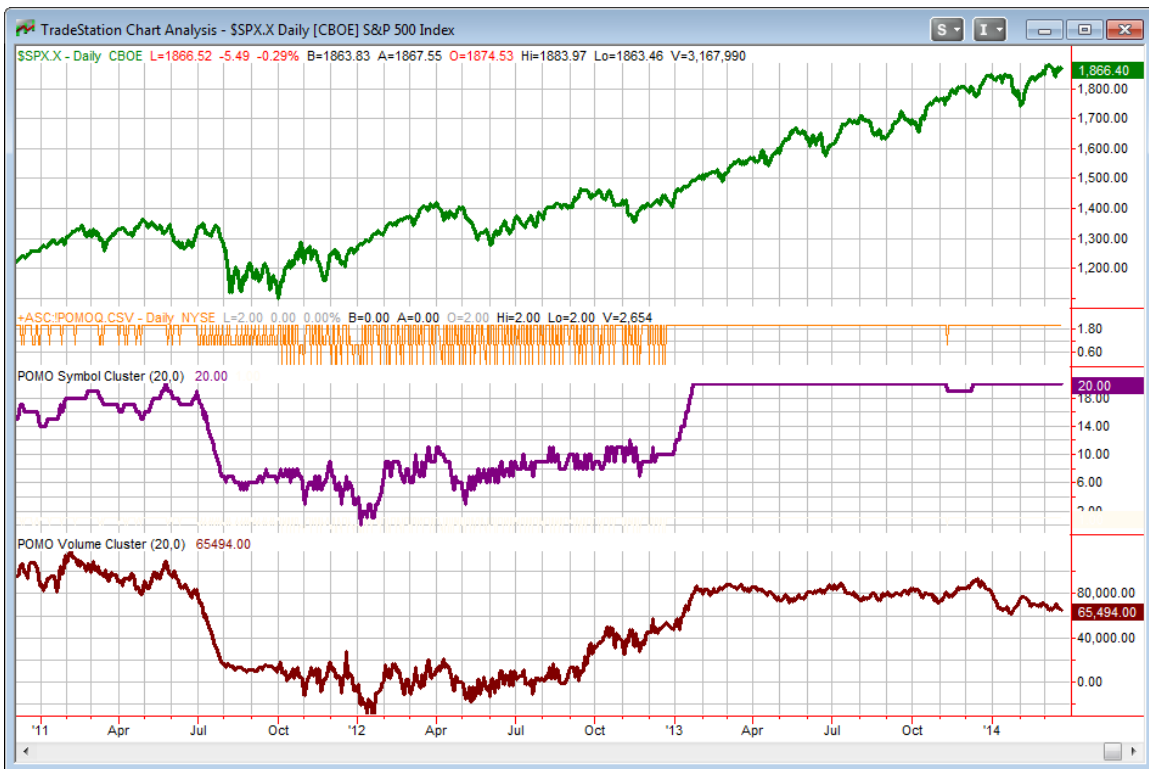
In fact, not only is the New High % diverging, it is still very far below the May level. And as I discussed in the Study of Tops and have reiterated here a number of times, the divergent New High % is a condition that has preceded every major SPX decline since 1970.

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 10 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 making new highs. 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 now bumping along at its lowered, tapered level. We estimate net inflows this past week to have been about \$14.7 billion. This is the lowest level of any week in March, and it could leave the market susceptible to a pullback sometime this upcoming week.

This week we expect to see inflows of about \$15.6 billion. That is about average for March. But thanks to the announcement from the Fed on Wednesday of further tapering

starting in April, it appears unlikely that the \$15.6 billion of buying will be outdone anytime soon.

The outlook really has not changed much from last week, but I did ratchet it back from “slightly bullish” to “neutral”. I may be a little early moving to neutral here. The market still has the trend on its side. There is a price action-based study from last week suggesting an upside edge. And while tapering is continuing and the Fed is pumping less and less, they are still pumping. On the other hand, the NASDAQ composite is now lagging the SPX and the rally continues to narrow. I remain willing to trade both sides of the market. I may favor longs slightly since the QE Buying Power Index is still bullish with the Fed still pumping. But I will play it pretty conservatively with both longs and shorts for a while here.

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.

Current Open Trade Ideas

None.

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