

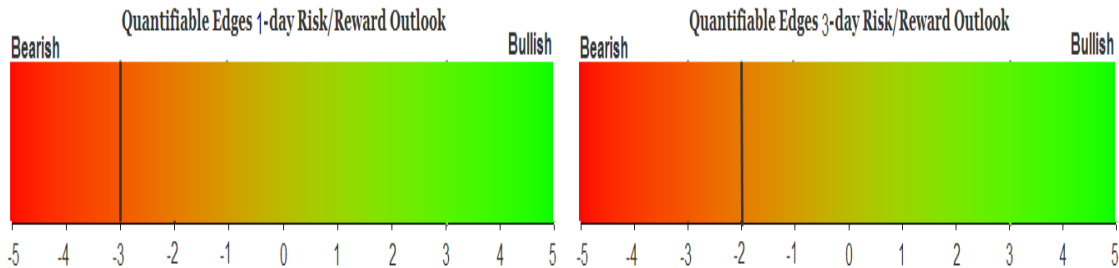
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 12, 2014

Volume 7 Issue 90

## Market Overview



## Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing
Short	100% Short SPY	Flat

## Tonight's Research Points

- Monday's mild up close near the top of its range suggests a bearish 1-day edge.
- The Russell 2000 has shown continued weakness while the SPX has held up well.

## *Short-term Outlook*

### *The Bottom Line*

The Aggregator flipped on Friday afternoon and is now suggesting a mild bearish edge. The SPX is overbought versus expectations but that will only last 1 day unless it continues to rally on Monday. So while there appears to be a short-side edge, it does not appear strong enough to get me interested in taking a position just yet.

**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>				
May 12, 2014	Up < 0.25% but top 10% of range	1 day	Bearish	
<b>Active - Long Term</b>				
May 1, 2014	3 of 4 Market Timing Indicators weak	int term	Bearish	
April 28, 2014	Sell in May	6 months	Bearish	
April 22, 2014	5 Days Higher < 50 but > 200	1-15 days	Bullish	
April 17, 2014	3 days up gain 2%. 3/10 Offset HV < 0.25	1-19 days	Bullish	
April 7, 2014	SPX new high while NDX huge drop	1-50 days	Bullish	
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	
<b>Dropped Tonight</b>				
May 7, 2014	5 lower gaps	1-3 days	Bullish	
April 29, 2014	High-volume up day	1-10 days	Bullish	2.50%

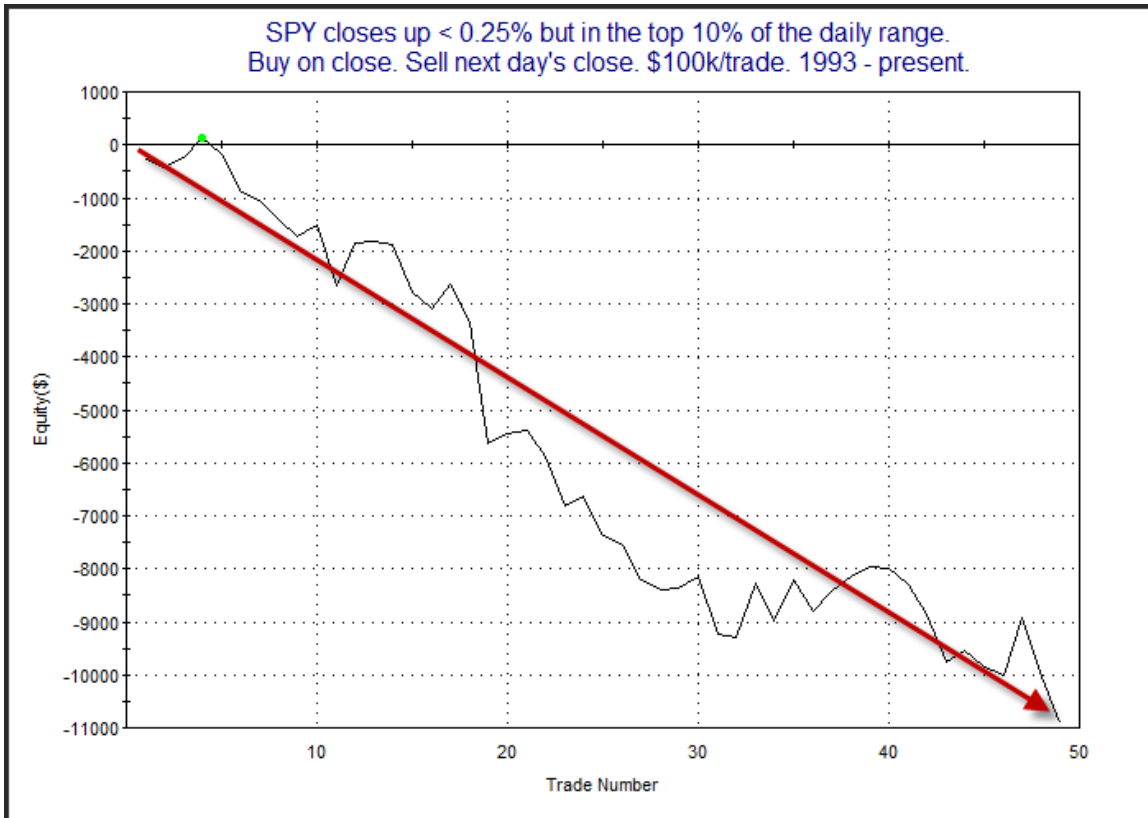
**The Evidence**

It was a tough start but a strong finish on Friday, leaving the major indices with gains on the day. The SPX rose 0.2%, the NASDAQ gained 0.5%, and the Russell 2000 rallied 0.9%. Breadth was mixed as the NYSE Up Issues % came in at 56% and the Up Volume % was 47%. Total NYSE volume dropped for the 2<sup>nd</sup> day in a row.

The moderate action triggered only 1 short-term study in the Quantifinder that showed compelling results. It was also seen just a few days ago in the 5/6/14 Letter. It suggests that when SPY closes strong (in the top 10% of its range) but still only manages a small gain on the day, that the next day has a downside tendency. Stats are updated.

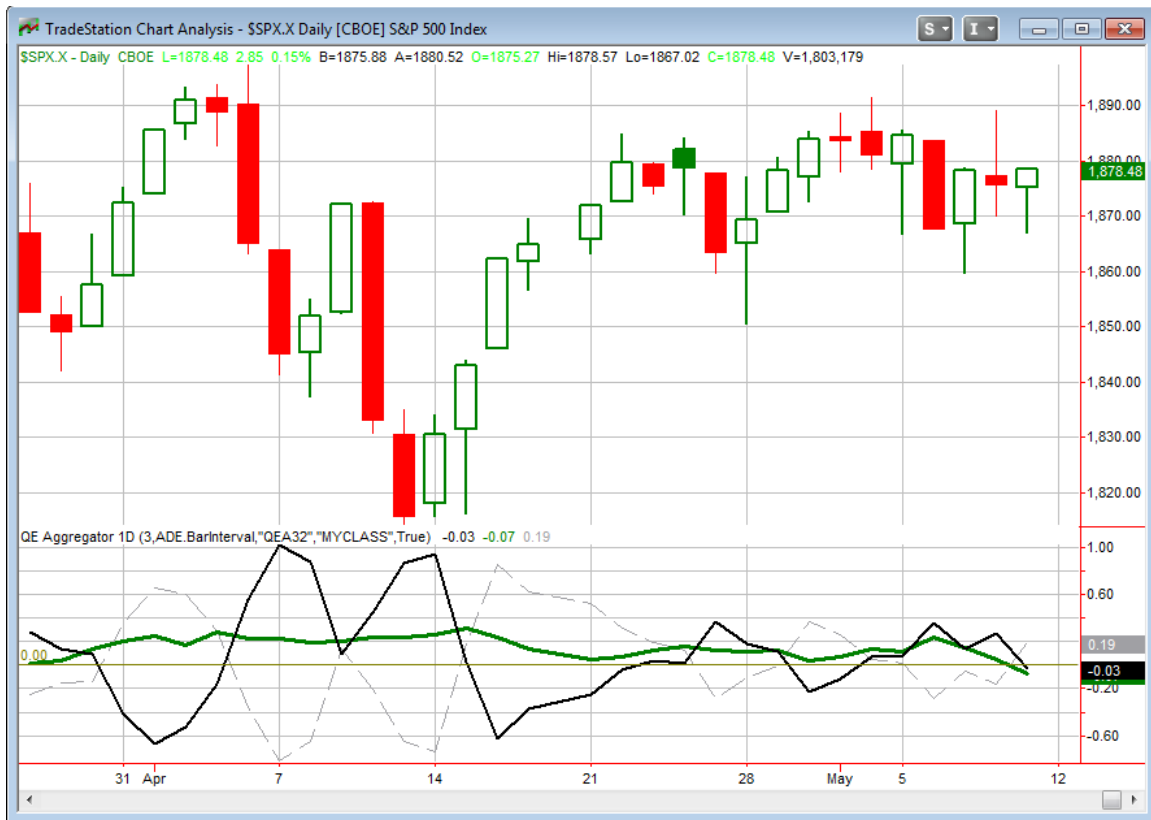
SPY closes up < 0.25% but in the top 10% of the daily range. Buy on close. Sell next day's close. \$100k/trade. 1993 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	(\$10,904.84)	Profit Factor	0.38
Gross Profit	\$6,736.44	Gross Loss	(\$17,641.28)
Total Number of Trades	49	Percent Profitable	36.73%
Winning Trades	18	Losing Trades	31
Even Trades	0		
Avg. Trade Net Profit	(\$222.55)	Ratio Avg. Win:Avg. Loss	0.66
Avg. Winning Trade	\$374.25	Avg. Losing Trade	(\$569.07)
Largest Winning Trade	\$1,093.35	Largest Losing Trade	(\$2,290.72)

As you can see there appears to be a bit of a bearish inclination. Below is a profit curve showing how the edge has played out over time.



It appears that when the market needs to expend a fair amount of energy just to squeak out a small gain, that its lack of momentum is often followed by a swing back in the opposite direction the next day. I have included this study on the Active List again tonight.

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



Tonight's bearish study helped the green Aggregator Line fall slightly below 0. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line also fell below 0. The negative Differential Line reading means the SPX is overbought versus recent expectations. So expectations are negative and the SPX is overbought. This is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close below 0. Therefore the Aggregator signal turned short at the close.

With tonight's study expiring Monday afternoon there will be no more active short-term studies on Monday. And with the intermediate-term outlook slightly bearish, no new studies would leave the Aggregator line negative. Of course Monday's action will determine what new studies emerge, so the Aggregator Line value is wide open at this point. The Differential Pivot will be *inverted* at 1887.46 on Monday. That about 0.5% above Friday's close. An inverted pivot means that the Differential Line will cross through 0 if SPX closes flat. In this case, in order to remain overbought SPX is going to need to close up at least 0.5%. Otherwise, it will be considered oversold versus expectations.

So there appears to be a bit of a bearish edge. But the inverted pivot limits the opportunity. This is because the short signal will come off unless the market moves

strongly against you. So in cases like this, where the potential reward is limited, I will rarely look to take a position. That is the case here today as well.

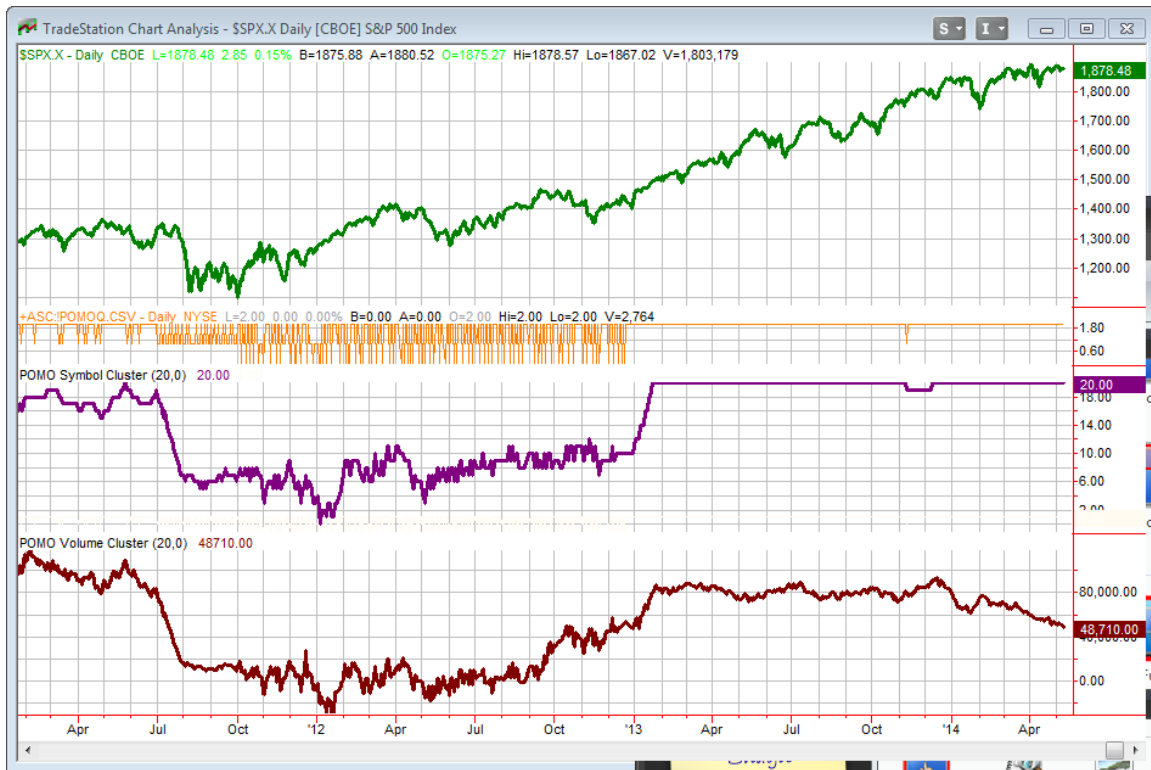
***Intermediate-term Outlook (2 weeks – 2 months) – updated 5/12– slightly bearish***

The market ended up with mild losses this past week for the SPX, the NASDAQ, and the Russell 2000. SPX is still not too far below a new high, but the Russell 2000 is now trading below its 200-day moving average.

It pretty rare to see such a split. I looked back at other times the SPX closed within 1% of a new 200-day high while the Russell 2000 was below its 200ma. Instances were pretty rare, with the last occurrence in 2006. But I found no consistency among the results. (Same goes for a 10% Russell correction while SPX is within 1% of a new high.) The divergence, while unusual, does not appear to be terribly predictive of intermediate-term strength or weakness.

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 and 2014 so far. The volume indicator is continuing to drift lower, and it is now at its lowest level since 2012. We estimate net inflows this past week to have been about \$10.7 billion. This is lower than last week, but above what we are expecting for the next 2 weeks. The liquidity backdrop is continuing to deteriorate, but there is still stimulus being pumped in. So it is a positive force, just a much smaller positive force than the market has become accustomed to.

I am still leery of this market. We have weak seasonality, declining (yet still positive) Fed-induced liquidity, and a [continued New Highs divergence](#) as outlined in the Study of Tops. Additionally, three of the four indicators from the [QE Market Timing Course](#) are negative, and the market has historically struggled under these conditions. On the plus side, the trend is still up (for the SPX at least). There are some price-action based studies from April that were intermediate-term bullish, but 2 of them are set to expire in the next few days. So with the buildup of bearish intermediate-term indications and the declining bullish indications, I am keeping my outlook at slightly bearish. I would not be surprised to see a correction of 10% or more emerge at some point in the next 3-6 months (and the Russell already did this from the 3/4/14 high to the 5/9/14 low). This means I will demand a bit more before jumping into long positions. I will also be looking for short opportunities.

## **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**

<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>
<i>SPY(1/4)</i>	<i>5/7/2014</i>	<i>\$186.78</i>	<i>\$187.69</i>	<i>0.49%</i>		<i>sold on open</i>

*SPY was sold at the open as per the Thursday night subscriber letter.*

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