

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 4, 2012

Volume 5 Issue 2

Market Overview



Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Flat	50% Long XIV	Flat	Flat

Tonight's Research Points

- Strong days that leave unfilled gaps up but close poorly will often see more buying over the short-term.
- Strong breadth for the 2nd day in 3 and a new 10-day high suggests short-term bullish implications.

Short-term Outlook

The Bottom Line

Expectations are mildly positive and the market is overbought. I'm neutral and playing the waiting game.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
January 4, 2012	SPY strong day but weak finish	1-3 days	Bullish	
January 4, 2012	2 of 3 days Up Issue %>75. 10-high.	1-6 days	Bullish	2.50%
January 3, 2012	Overbought w/out POMO support	1-5 days	Bearish	-2.70%
December 28, 2011	5 Days Up > 200 no 50-high	1-10 days	Bullish	2.00%
Active - Long Term				
December 28, 2011	5 Days Up > 200 no 50-high	1-15 days	Bullish	
December 5, 2011	POMO scheduled to turn negative	int term	Bearish	
October 30, 2011	SPX & bond yields hit 50-day highs	1-50 days	Bearish	
October 19, 2011	FTD on strong breadth/20day high	int term	Bullish	
Dropped Tonight				
November 18, 2011	Triangle breakdown	int term	Bullish	
December 30, 2011	Unfilled gap up inside day. C>200&Opn	1-2 days	Bearish	
December 29, 2011	1% drop after Christmas	1-3 days	Bullish	2.00%
December 12, 2011	Seasonal strength into year end	thru 1/3	Bullish	

If the avg max move is achieved the study will appear in **bold italic blue** and no longer be active.

The Evidence

What a start to 2012! The market opened very strong, and despite a late selloff, held on for sizable gains. The SPX, Nasdaq, and Russell 2000 all rose between 1.55% and 1.7%. Breadth was strongly positive as the NYSE Up Issues % came in at 77% and the Up Volume % was 80%. Total NYSE volume spiked above recent levels.

The late selloff and weak close may have been disappointing to some, but if you're long the market then it shouldn't bother you. I've shown a number of times that weak closes on strong days are often followed by further rallying over the short-term. I'll demonstrate this a few different ways tonight.

The excerpt below is from the 4/4/11 subscriber letter. I have updated all stats except the 1st table.

I ran a test of performance following unfilled upside gaps that make a 20-day high. Below I've broken out the results by times the SPY closed above the open versus times where it closed below the open.

First let's look at those times where the finish was relatively strong:

(Table not updated)

SPY posts a 20-day intraday high & a low > yesterday's close. It then closes ABOVE the open and > 200ma. 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: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	3,615.91	104	54	48	51.92	1,780.30	-1,927.51	0.92	1.04	34.77
9	9,421.93	110	62	47	56.36	1,560.61	-1,858.21	0.84	1.11	85.65
8	-934.54	115	65	48	56.52	1,379.90	-1,888.09	0.73	0.99	-8.13
7	-1,113.67	119	68	49	57.14	1,230.42	-1,730.25	0.71	0.99	-9.36
6	5,993.31	124	62	61	50.00	1,136.09	-1,056.46	1.08	1.09	48.33
5	9,847.26	127	67	58	52.76	1,034.59	-1,025.34	1.01	1.17	77.54
4	12,691.48	140	79	60	56.43	971.39	-1,067.48	0.91	1.20	90.65
3	1,115.41	152	88	63	57.89	686.88	-941.75	0.73	1.02	7.34
2	-5,504.89	159	83	75	52.20	545.51	-677.10	0.81	0.89	-34.62
1	3,697.58	169	86	82	50.89	423.08	-398.62	1.06	1.11	21.88

There doesn't appear to be any edge in either direction here. Now let's examine times like the present where SPY closed below the open.

SPY posts a 20-day intraday high and an unfilled gap up. Close < open but > 200ma. 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: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	25,573.10	27	16	11	59.26	2,527.53	4,838.35	-1,351.57	-4,810.68	1.87	2.72	947.15
9	19,264.50	27	19	8	70.37	1,776.16	3,741.10	-1,810.33	-5,564.16	0.98	2.33	713.50
8	17,033.79	27	18	8	66.67	1,792.33	3,352.48	-1,903.52	-6,021.40	0.94	2.12	630.88
7	16,269.01	27	16	11	59.26	1,946.72	3,751.55	-1,352.59	-4,952.36	1.44	2.09	602.56
6	17,392.46	27	17	10	62.96	1,856.99	4,159.10	-1,417.63	-6,414.24	1.31	2.23	644.17
5	14,626.60	27	15	12	55.56	1,666.64	3,754.17	-864.42	-4,540.20	1.93	2.41	541.73
4	15,062.93	27	19	8	70.37	1,127.21	3,436.02	-794.26	-2,228.24	1.42	3.37	557.89
3	18,453.66	29	21	7	72.41	1,110.04	2,362.10	-693.89	-2,427.88	1.60	4.80	636.33
2	11,789.38	30	18	12	60.00	1,010.42	1,998.70	-533.18	-926.12	1.90	2.84	392.98
1	4,661.83	31	19	12	61.29	523.50	1,708.92	-440.39	-1,015.84	1.19	1.88	150.38

27 of 31 instances (87%) posted a close above the entry price at some point in the next 3 days.

These results are substantially better than earlier where the finish was good. Rather than worrying about the weak finish bulls should be excited by it.

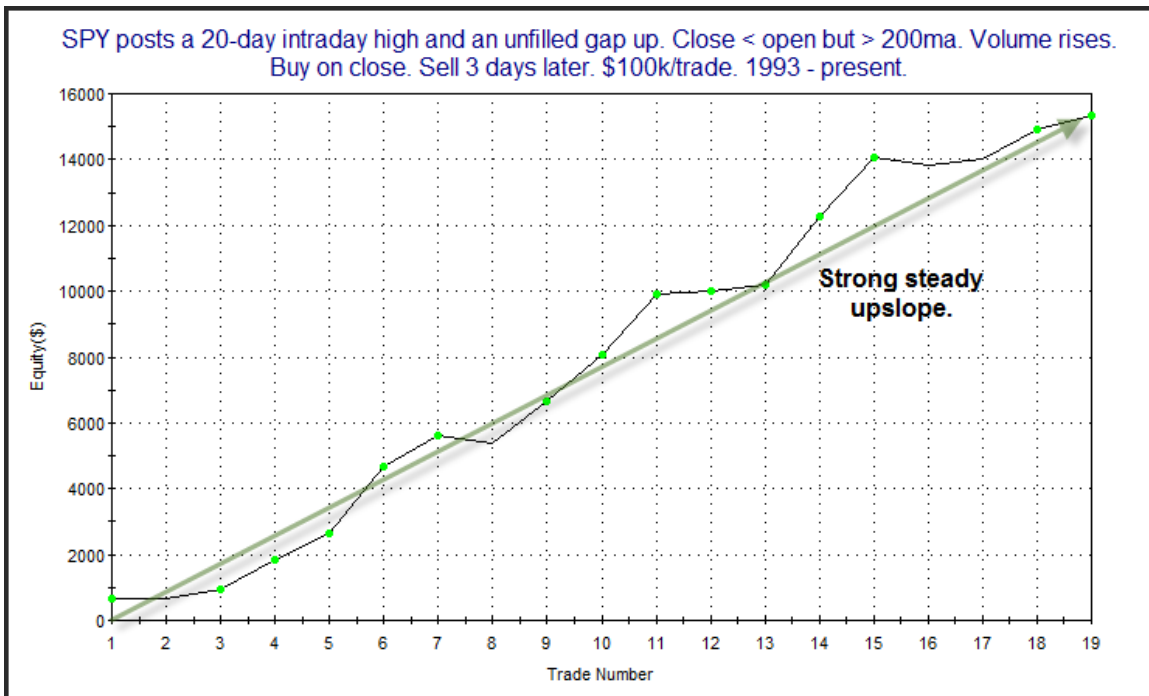
I also added another filter to see what a rise in SPY volume might mean.

SPY posts a 20-day intraday high and an unfilled gap up. Close < open but > 200ma. Volume rises.
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: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	23,872.43	18	11	7	61.11	2,776.17	3,751.11	-952.21	-2,117.20	2.92	4.58	1,326.25
9	18,065.15	18	13	5	72.22	1,834.13	3,384.84	-1,155.71	-1,837.44	1.59	4.13	1,003.62
8	16,568.51	18	12	5	66.67	1,883.60	3,352.48	-1,206.93	-1,581.20	1.56	3.75	920.47
7	15,636.11	18	11	7	61.11	2,034.66	3,310.89	-963.59	-1,451.12	2.11	3.32	868.67
6	16,521.67	18	12	6	66.67	1,888.18	3,008.79	-1,022.75	-2,000.96	1.85	3.69	917.87
5	11,641.98	18	9	9	50.00	1,772.02	3,754.17	-478.46	-1,879.20	3.70	3.70	646.78
4	14,578.31	18	14	4	77.78	1,140.03	3,436.02	-345.53	-628.68	3.30	11.55	809.91
3	15,316.32	19	16	2	84.21	988.27	2,056.39	-247.98	-252.60	3.99	31.88	806.12
2	9,380.32	20	13	7	65.00	937.03	1,998.70	-400.16	-926.12	2.34	4.35	469.02
1	7,025.25	20	15	5	75.00	561.04	1,708.92	-278.07	-479.96	2.02	6.05	351.26

19 of 20 instances (95%) posted a close above the entry price at some point in the next 3 days.

Results here appear solid all around and the edge even plays out a little longer than the 3-4 days of the previous study. To get an idea of how the edge has looked over time I have created an equity curve using a 3-day exit below.



Equity curves don't often get much straighter than this.

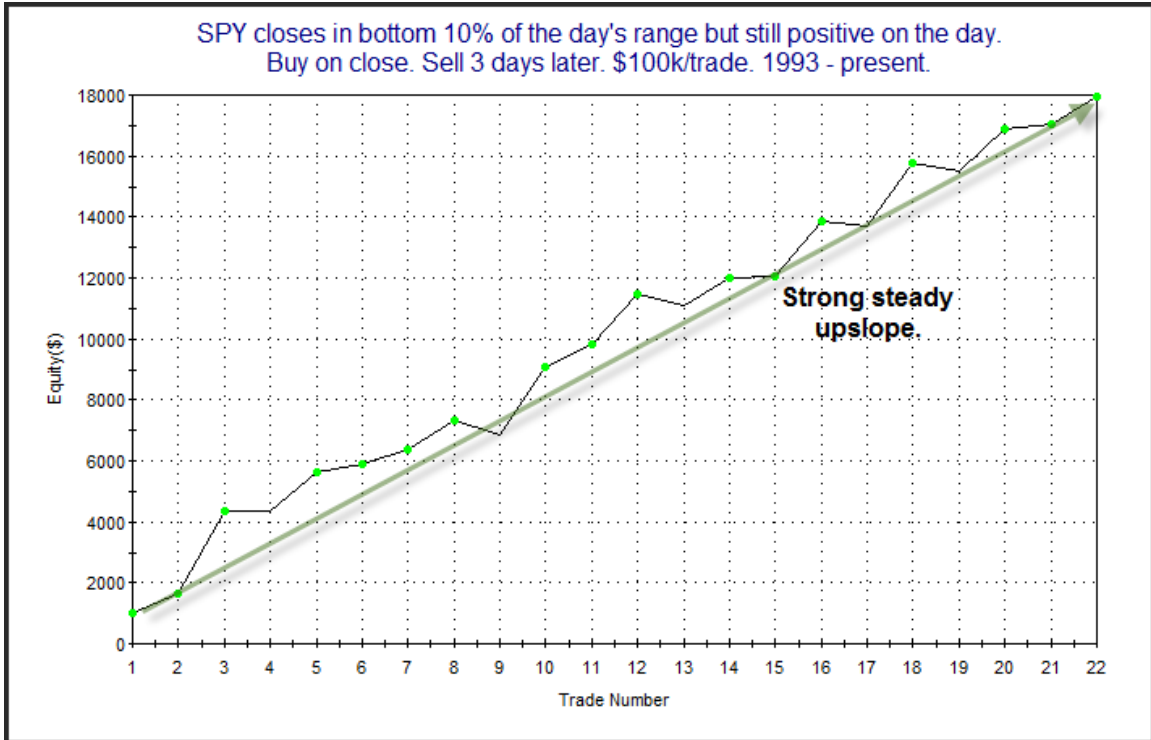
The next study with the “weak close” theme that I will review was last seen in the 10/26/10 letter. It doesn’t require a 20-day high but it does require a very weak close – in the bottom 10% of the daily range. Results are updated.

**SPY closes in bottom 10% of the day's range but still positive on the day.
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: 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	11,663.18	21	14	7	66.67	1,406.27	3,458.95	-1,146.38	-2,337.14	1.23	2.45	555.39
4	13,806.83	22	17	5	77.27	1,138.35	2,312.35	-1,109.01	-3,623.88	1.03	3.49	627.58
3	17,964.68	22	17	4	77.27	1,127.26	2,694.00	-299.67	-472.68	3.76	15.99	816.58
2	13,060.52	22	15	7	68.18	1,032.15	3,028.76	-345.95	-531.70	2.98	6.39	593.66
1	8,748.56	23	17	6	73.91	672.42	3,476.36	-447.09	-903.90	1.50	4.26	380.37

All 23 instances posted a close above the entry price at some point in the next 4 days.

Results here appear strong and pretty closely in line with the previous study. I generated a 3-day profit curve below.



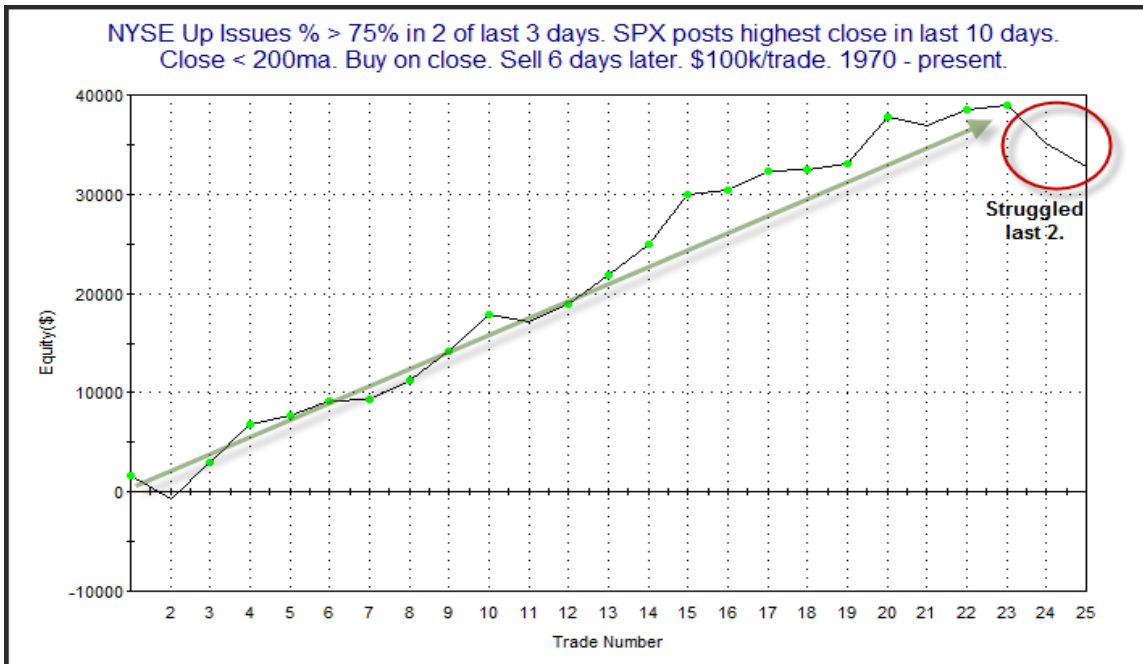
This curve is almost as straight as the arrow, and acts as confirmation of the bullish edge.

Another study that appeared in the Quantifinder examined the strong breadth we have now seen in 2 of the last 3 days, and the fact that the market closed at a 10-day high. It was last seen in the 7/22/11 subscriber letter and has been updated below.

NYSE Up Issues % > 75% in 2 of last 3 days. SPX posts highest close in last 10 days. Close < 200ma. Buy on close. Sell X days later. \$100k/trade. 1970 - 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
20	47,944.62	21	16	5	76.19	4,912.07	10,448.44	-6,129.71	-15,033.10	0.80	2.56	2,283.08
19	50,027.28	22	17	5	77.27	4,593.61	10,910.56	-5,612.80	-11,094.08	0.82	2.78	2,273.97
18	49,558.15	22	18	4	81.82	4,150.05	8,727.84	-6,285.70	-11,176.96	0.66	2.97	2,252.64
17	48,335.40	22	18	4	81.82	4,089.68	9,187.20	-6,319.72	-10,308.94	0.65	2.91	2,197.06
16	47,177.88	22	18	4	81.82	4,015.19	9,539.88	-6,273.87	-12,209.26	0.64	2.88	2,144.45
15	37,024.89	22	16	6	72.73	4,043.82	8,941.56	-4,612.69	-12,665.84	0.88	2.34	1,682.95
14	30,565.95	22	18	4	81.82	3,381.83	7,807.79	-7,576.75	-16,504.96	0.45	2.01	1,389.36
13	34,196.74	23	17	6	73.91	3,442.08	8,597.16	-4,053.10	-12,673.98	0.85	2.41	1,486.81
12	29,223.86	24	17	7	70.83	3,423.88	7,623.04	-4,140.29	-16,601.16	0.83	2.01	1,217.66
11	38,064.08	24	18	6	75.00	3,193.65	7,783.28	-3,236.92	-10,687.08	0.99	2.96	1,586.00
10	31,173.23	24	18	6	75.00	3,002.75	7,954.00	-3,812.70	-10,636.02	0.79	2.36	1,298.88
9	33,210.70	24	17	7	70.83	3,118.12	8,085.92	-2,828.18	-6,176.04	1.10	2.68	1,383.78
8	31,082.97	24	18	6	75.00	2,516.31	6,037.28	-2,368.45	-6,641.50	1.06	3.19	1,295.12
7	32,478.33	24	17	7	70.83	2,580.25	6,145.92	-1,626.56	-4,207.64	1.59	3.85	1,353.26
6	32,783.17	25	20	5	80.00	2,145.86	5,002.50	-2,026.80	-3,812.48	1.06	4.23	1,311.33
5	27,663.12	25	18	7	72.00	1,996.35	4,482.50	-1,181.61	-3,191.62	1.69	4.34	1,106.52
4	18,682.55	26	19	7	73.08	1,497.08	6,138.16	-1,394.58	-3,595.13	1.07	2.91	718.56
3	10,083.32	26	16	10	61.54	1,382.97	4,376.64	-1,204.43	-5,105.87	1.15	1.84	387.82
2	7,261.76	29	17	12	58.62	1,072.59	4,399.92	-914.36	-3,149.67	1.17	1.66	250.41
1	6,104.40	31	19	12	61.29	626.45	1,848.00	-483.18	-1,564.34	1.30	2.05	196.92

All 31 instances posted a close above the entry price at some point in the next 6 days.

The consistency suggesting at least some short-term follow through is extremely strong. While the edge appears to persist for up to a few weeks, a large portion of that edge has played out over the 1st 6 days. Below is a profit curve that assumes a 6-day exit.



This profit curve was extremely straight for a long period of time, but the last 2 instances have both seem declines over the 6-day period. This isn't enough to concern me deeply yet, but it will be important to monitor this study to see whether it may be losing effectiveness.

All in all the market provided us with some pretty solid short-term bullish evidence to start the year. Of course it is bucking up against the short-term overbought condition and negative short-term POMO flows that I discussed in detail yesterday. So let's see how it plays out in the Aggregator.

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



Tonight's bullish evidence caused the green Aggregator line flip back positive after just one day in negative territory. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line dipped quite a bit with the strong move up in the SPX, and finished well below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are bullish but the SPX is overbought versus recent expectations. 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 System to remain flat at the close. This was indicated on the systems page before the bell.

Based on the current active studies, expectations are scheduled to remain positive on Wednesday. Of course this could change if strong bearish evidence emerges. The Differential Pivot will be 1,266.68 on Wednesday. This is 0.8% below Tuesday's close. So the SPX will need close down at least this much for the Differential line to rise back into positive territory.

The Aggregator is still neutral and I am not inclined to start taking on new exposure until I see a more substantial edge. So I'll wait another day and see what the market delivers.

Intermediate-term Outlook (2 weeks – 2 months)– updated 1/3 – neutral

The intermediate-term outlook was last updated in the 1/3/12 letter. It may be accessed using the link below:

[2012-01-03 QE Subscriber Letter.pdf](#)

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 [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

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
XIV(1/2)	11/21/2011	\$4.91	\$6.86	39.71%	\$6.25	may exit if Agg "short"
SPY(1/4)	11/30/2012	\$125.50	\$127.76	1.80%		<i>sold on open</i>

SPY was sold at the open as per last night's letter. A little luck to start the year might be a nice omen.

Tonight's bullish evidence has me hanging on to XIV a little longer. I did decide to raise the stop substantially from \$5.29 up to \$6.25 tonight. That should help to lock in a decent amount of profits and still gives it a little space below the swing low a couple of days ago.

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