

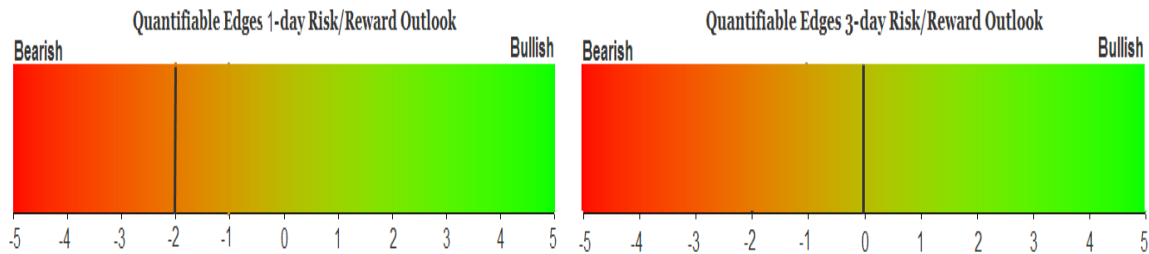
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 12, 2012

Volume 5 Issue 8

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- When SPX posts an inside day today after a 50-day high breakout yesterday, it suggests further buying over the next week.
- When SPX closes at a 50-day high and VIX closes up mid-week it is often followed by 1-2 days of weakness.

## Short-term Outlook

### The Bottom Line

Not much movement on Wednesday. And not much has changed. The market remains overbought and expectations are positive. One-day expectations are negative, though which is causing the “-2” reading on the 1-day outlook above.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
January 12, 2012	Breakout then inside day	1-5 days	Bullish	1.50%
January 12, 2012	SPX 50-high. VIX up midweek.	1-2 days	Bearish	-0.80%
January 11, 2012	Breakaway gap	1-5 days	Bullish	1.70%
January 10, 2012	Overbought w/out POMO support	1-5 days	Bearish	-2.70%
<b>Active - Long Term</b>				
January 4, 2012	2 of 3 days Up Issue %>75. 10-high.	1-18 days	Bullish	
December 28, 2011	5 Days Up > 200 no 50-high	1-15 days	Bullish	
December 5, 2011	POMO activity flat to 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	
<b>Dropped Tonight</b>				
January 4, 2012	2 of 3 days Up Issue %>75. 10-high.	1-6 days	Bullish	2.50%

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

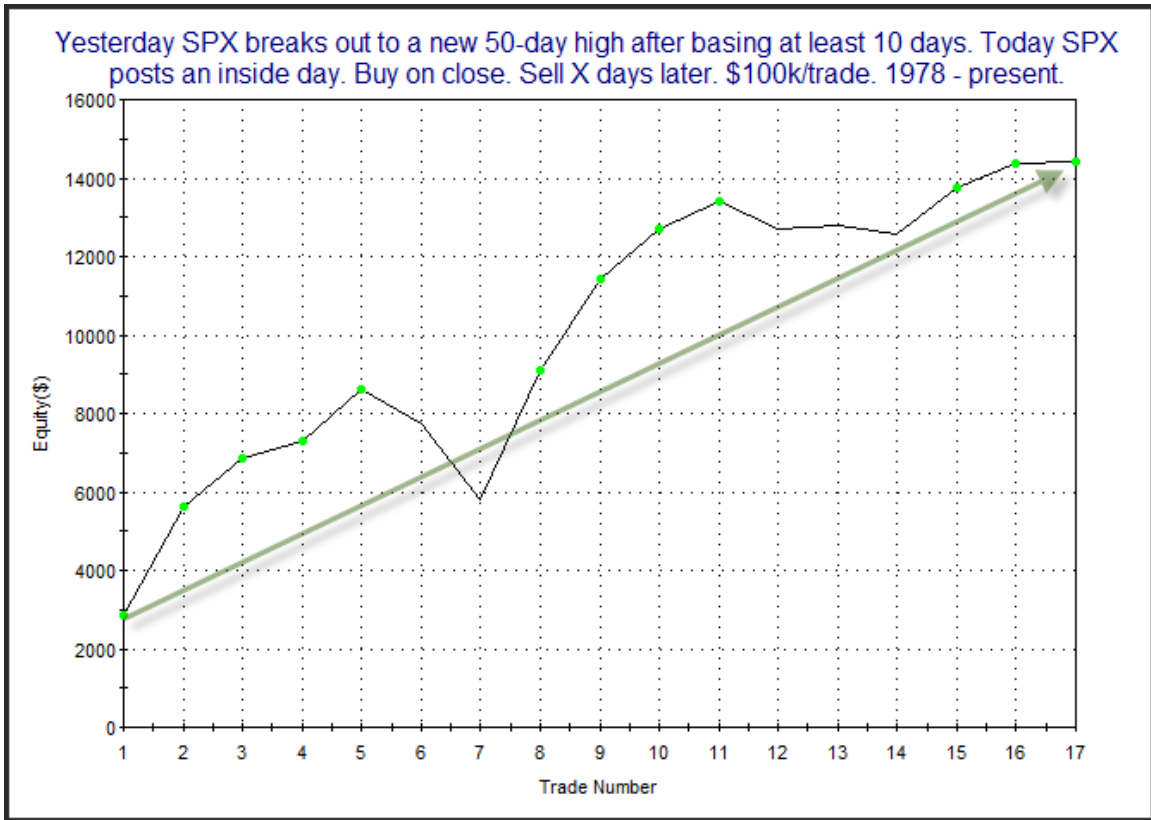
### *The Evidence*

Wednesday was a quiet day and the indices finished mostly higher. The SPX rose a meager 0.03% while the Nasdaq and the Russell 2000 each rallied 0.3%. Breadth was modestly positive as the NYSE Up Issues % came in at 53% and the Up volume % was 62%. Total NYSE volume dipped a bit from Tuesday's level.

The studies are mixed tonight. First let's look at one study with bullish inclinations. Tuesday was a breakout day for the market and we saw some evidence last night that the breakout is likely to see some short-term follow through. It got a little on Wednesday, but not much. While the SPX closed up, it never exceeded Tuesday's high, making it look like an inside day on the chart. This begs the question of whether the inside day is more likely a pause before a resumption of the breakout, or whether it signals the momentum is fading and the market will swing the other way. The study below is from the 8/4/10 and it attempts to answer that question.

Yesterday SPX breaks out to a new 50-day high after basing at least 10 days. Today SPX posts an inside day. Buy on close. Sell X days later. \$100k/trade. 1978 - 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	14,410.51	17	13	4	76.47	1,394.13	3,281.34	-928.30	-1,916.98	1.50	4.88	847.68
4	9,534.67	17	10	7	58.82	1,643.05	3,217.32	-985.12	-2,926.98	1.67	2.38	560.86
3	4,846.14	17	12	5	70.59	970.61	2,810.19	-1,360.24	-2,770.43	0.71	1.71	285.07
2	4,472.77	17	8	9	47.06	1,273.54	2,622.42	-635.06	-1,372.28	2.01	1.78	263.10
1	-1,118.41	17	5	12	29.41	1,148.99	2,142.00	-571.95	-1,699.88	2.01	0.84	-65.79

Based on the stats it appears that after day 1 a resumption of the uptrend is the more likely scenario. Below is a profit curve that uses a 5-day exit strategy.



A bit choppy but the general upslope appears good enough that the study seems worthy of consideration.

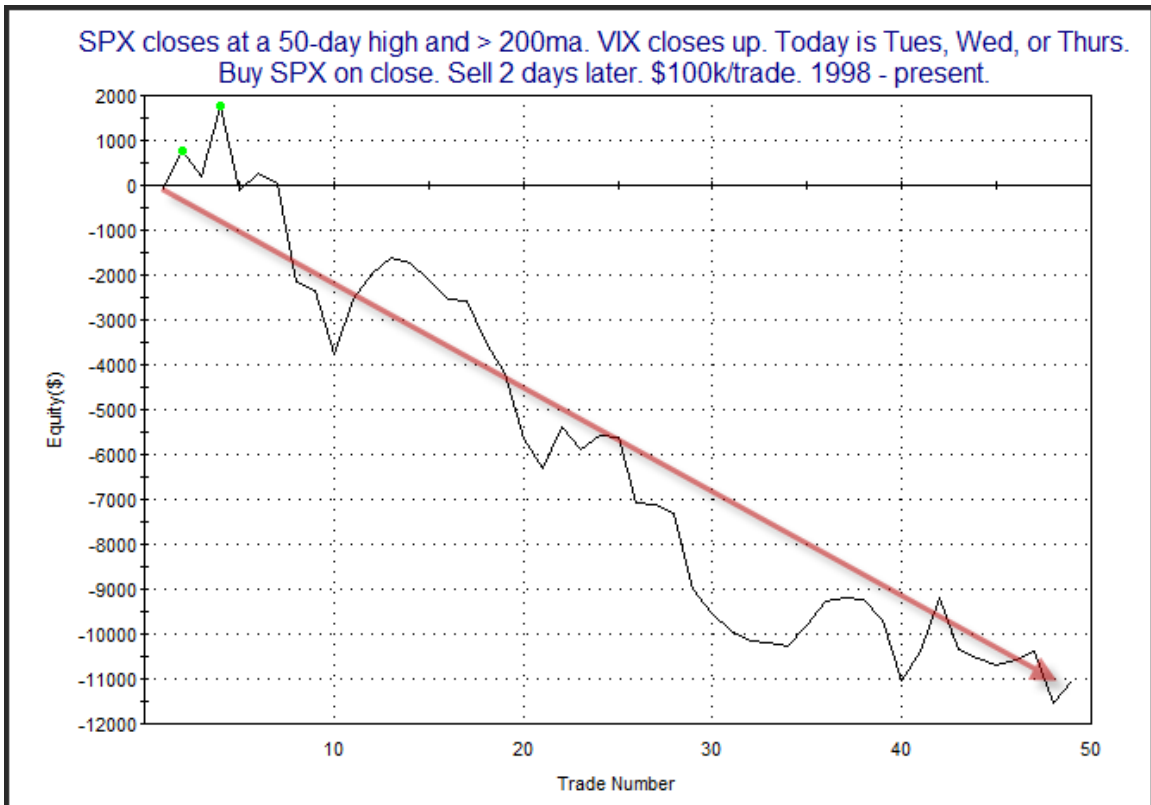
On the bearish side, VIX action seemed to suggest a pullback in the next 1-2 days could be in the making. The study below was last seen in the 2/17/11 subscriber letter. With VIX studies I often separate out mid-week action versus Mondays and Fridays because of the natural tendency of the VIX to decline ahead of the weekend and the rise on Mondays. I did this in the below study as well.

SPX closes at a 50-day high and > 200ma. VIX closes up. Today is Tues, Wed, or Thurs.  
Buy SPX on close. 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
5	-14,578.65	46	23	23	50.00	677.38	2,108.40	-1,311.23	-4,171.80	0.52	0.52	-316.93
4	-12,191.28	48	19	29	39.58	803.17	1,719.75	-946.60	-4,354.72	0.85	0.56	-253.99
3	-7,068.94	48	21	27	43.75	690.02	2,381.25	-798.49	-2,091.82	0.86	0.67	-147.27
2	-11,044.23	49	16	33	32.65	622.71	1,609.50	-636.59	-2,182.68	0.98	0.47	-225.39
1	-8,370.33	56	25	31	44.64	302.57	1,281.75	-514.02	-1,721.70	0.59	0.47	-149.47

**92% of instances posted a close below the entry price at some point in the next week.**

Pullbacks of some kind have been quite reliable, with most of the damage occurring in the 1<sup>st</sup> two days. Below is an equity curve that shows how the edge has played out over time.



The fairly steady decline seems to support the idea of a short-term downside edge.

So we have one bullish and one bearish study tonight. As usual I will look to the Aggregator to help sort it out.

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



The Aggregator chart looks much the same as last night. The green Aggregator Line remains slightly positive. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line is still a little 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 already 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.

Based on the current active studies, expectations are scheduled to remain positive on Thursday. Of course this could change if more bearish evidence emerges. The Differential Pivot will be 1,279.74 on Thursday. This is about 1% below Wednesday's

close. So the SPX will need to close lower by at least this much in order to turn the Differential Line positive.

There simply doesn't appear to be a very strong edge here. I'm not inclined to get involved at this point and will continue to wait for a more attractive opportunity. I will note that while the Aggregator is neutral the 1-day risk/reward outlook at the top of this letter is negative. That is because although expectations are positive over the next 3 days, expectations for Thursday are actually negative. This kind of 1-day edge is something I would normally only consider trying to take advantage of with a daytrade. Since I am going to be out of the office Thursday that is not even a consideration. And it wouldn't make a difference for the Trade Ideas section. That would look the same anyway, with me standing aside until a better edge emerges.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 1/9 – neutral***

The intermediate-term outlook was last updated in the 1/9/12 letter. It may be accessed using the link below:

[2012-01-09 QE Subscriber Letter.pdf](#)

**Catapult and Capitulative Breadth Statistics**

*Catapult & CBI Presentation Link*

***Open Catapult Triggers***

*MO – bought 1/3 @ \$28.40 (filled)*

***Catapult for ETF's Trades***

*None.*

***Broad Market Large Cap CBI – 1(MO)***

### 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
MO(1/3)	1/5/2012	\$28.40	\$28.84	1.55%	\$28.09	Catapult
VZ(1/3)	1/9/2012	\$38.33	\$38.90	1.49%		<i>Sell on open</i>

*VZ hit it's exit target this afternoon. Gold subscribers were sent notice of this in an intraday update in case they wanted to take profits. The "official" exit price will be Thursday's open.*

*MO needs to trade up to about \$29.05 intraday or close at an estimated \$28.97 or higher in order to hit its exit target. If either of these things happens then it will be exited on Friday's open.*

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