

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 18, 2012

Volume 5 Issue 11

## Market Overview



## Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Short	100% Short SPY	Flat	Flat

## Tonight's Research Points

- The 20-day high and unfilled gap study we have seen a recently triggered again, but this time without higher volume. When volume is lower inclinations no longer appear bullish.
- The VIX spike & SPX rise suggest an upside edge on days other than Monday. Unfortunately, Tuesday was the 1<sup>st</sup> day of the week, making it like a Monday.

## *Short-term Outlook*

### *The Bottom Line*

The Aggregator is suggesting a slight bullish edge. It isn't enough for me to take on long exposure just yet. I'm awaiting more compelling evidence and reward/risk opportunity before taking a position.

## *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 17, 2012	MLK/Jan opex week bearish	1-4 days	Bearish	
January 12, 2012	Breakout then inside day	1-5 days	Bullish	1.50%
January 11, 2012	Breakaway gap	1-5 days	Bullish	1.70%
<b>Active - Long Term</b>				
January 4, 2012	2 of 3 days Up Issue %>75. 10-high.	1-18 days	Bullish	
December 5, 2011	POMO activity flat to negative	int term	Bearish	
October 19, 2011	FTD on strong breadth/20day high	int term	Bullish	

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

***The Evidence***

A strong gap up failed to follow through and the market spent most of the day giving back much of the morning gains. In the end there were still some gains to be had, though. The SPX rose 0.4%, the Nasdaq rallied 0.6%, and the Russell 2000 finished up 0.2%. Breadth was modestly positive as the NYSE Up Issues % came in at 61% and the Up Volume % was 56%. Total NYSE volume dipped a little from Friday’s level after running higher for much of the day.

In my initial review of triggering studies it appeared that a few with short-term bullish influence might be emerging. Closer examination of circumstances is showing no such inclinations. I’ll review why below.

In the 1/11/12 letter last week I looked at unfilled upside gaps that make a 20-day intraday high. I found that when the SPY closed below its open performance was much better going forward than when it closed above its open. I also found that the stats were even better when the SPY put in the pattern with rising volume. We did not get the rising volume today so I took a look at that scenario. First, below are results when volume rose. (Not updated.)

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	12,919.90	19	10	9	52.63	1,722.61	3,754.17	-478.46	-1,879.20	3.60	4.00	679.99
4	14,985.99	19	15	4	78.95	1,091.21	3,436.02	-345.53	-628.68	3.16	11.84	788.74
3	15,480.96	20	17	2	85.00	939.82	2,056.39	-247.98	-252.60	3.79	32.21	774.05
2	9,803.68	21	14	7	66.67	900.34	1,998.70	-400.16	-926.12	2.25	4.50	466.84
1	7,182.05	21	16	5	76.19	535.77	1,708.92	-278.07	-479.96	1.93	6.17	342.00

**20 of 21 instances (95%) posted a close above the entry price at some point in the next 3 days.**

Results here look solid all around,

But now let’s look at the current setup without the volume.

SPY posts a 20-day intraday high and an unfilled gap up. Close < open but > 200ma. Volume declines. 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	-1,234.13	10	5	5	50.00	1,980.50	4,838.35	-2,227.33	-4,810.68	0.89	0.89	-123.41
9	-1,341.92	10	6	4	60.00	1,650.57	3,741.10	-2,811.34	-5,564.16	0.59	0.88	-134.19
8	-1,095.50	10	6	4	60.00	1,609.79	2,718.75	-2,688.56	-6,021.40	0.60	0.90	-109.55
7	-1,374.77	10	5	5	50.00	1,753.25	3,751.55	-2,028.21	-4,952.36	0.86	0.86	-137.48
6	-523.24	10	5	5	50.00	1,782.11	4,159.10	-1,886.76	-6,414.24	0.94	0.94	-52.32
5	3,551.57	10	7	3	70.00	1,374.07	3,647.05	-2,022.30	-4,540.20	0.68	1.59	355.16
4	-329.12	10	5	5	50.00	1,091.32	2,173.60	-1,157.14	-2,228.24	0.94	0.94	-32.91
3	3,130.67	11	5	6	45.45	1,499.72	2,362.10	-727.99	-2,427.88	2.06	1.72	284.61
2	3,222.80	11	6	5	54.55	1,136.64	1,858.87	-719.41	-906.28	1.58	1.90	292.98
1	-2,363.42	11	4	7	36.36	382.74	980.49	-556.34	-1,015.84	0.69	0.39	-214.86

While instances are too low to draw solid conclusions, there is nothing here suggesting an edge. The bullish inclinations that seemed evident when SPY volume is on the rise, are no longer apparent under declining-volume circumstances.

Another study that triggered was from the 6/17/11 subscriber letter. It looked at non-Mondays that saw the VIX spike up > 6% despite the SPX also rising. I have updated the results table below.

VIX closes up over 6% while SPY closes positive. Today is not Monday. Buy SPY 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	17,423.85	15	13	2	86.67	1,419.60	4,501.60	-515.48	-810.06	2.75	17.90	1,161.59
4	18,062.04	15	13	2	86.67	1,447.29	4,225.18	-376.36	-446.12	3.85	25.00	1,204.14
3	15,443.71	15	14	1	93.33	1,109.69	4,576.06	-91.98	-91.98	12.06	168.90	1,029.58
2	9,474.21	16	12	4	75.00	965.33	2,807.04	-527.43	-790.40	1.83	5.49	592.14
1	3,052.85	17	10	7	58.82	611.20	1,893.29	-437.02	-1,546.98	1.40	2.00	179.58

100% of instances closed above the entry price at some point in the next week.

The edge here appears to be strong. Below is a list of all the instances along with their 3-day results.

VIX closes up over 6% while SPY closes positive. Today is not Monday.  
Buy SPY on close. Sell 3 days later. \$100k/trade. 1993 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
03/31/94	Buy	\$44.60	0.47%	\$695.02
04/06/94	Sell	\$44.81		(\$2,802.50)
10/12/94	Buy	\$46.69	0.56%	\$1,370.24
10/17/94	Sell	\$46.95		\$0.00
11/23/94	Buy	\$45.25	0.91%	\$1,104.50
11/29/94	Sell	\$45.66		\$0.00
01/03/95	Buy	\$45.79	0.59%	\$1,004.18
01/06/95	Sell	\$46.06		(\$87.32)
05/04/95	Buy	\$52.25	0.54%	\$1,147.80
05/09/95	Sell	\$52.53		(\$325.21)
05/31/95	Buy	\$53.05	1.56%	\$1,903.85
06/05/95	Sell	\$53.88		\$0.00
12/05/95	Buy	\$62.14	0.05%	\$643.60
12/08/95	Sell	\$62.17		(\$579.24)
12/22/95	Buy	\$61.21	0.34%	\$751.18
12/28/95	Sell	\$61.42		\$0.00
02/06/96	Buy	\$64.77	1.65%	\$2,484.23
02/09/96	Sell	\$65.84		(\$108.01)
03/19/96	Buy	\$65.23	(0.09%)	\$475.23
03/22/96	Sell	\$65.17		(\$889.14)
09/03/96	Buy	\$65.75	0.29%	\$1,520.00
09/06/96	Sell	\$65.94		(\$1,109.60)
05/27/97	Buy	\$85.13	0.18%	\$504.82
05/30/97	Sell	\$85.28		(\$2,348.00)
03/17/00	Buy	\$146.94	2.14%	\$2,652.00
03/22/00	Sell	\$150.09		(\$1,659.20)
10/26/00	Buy	\$136.69	4.58%	\$5,117.00
10/31/00	Sell	\$142.95		(\$43.86)
06/16/11	Buy	\$127.30	1.69%	\$1,884.00
06/21/11	Sell	\$129.45		(\$565.20)

Results appear very strong. But there is one substantial issue I have with utilizing this test today. That is the fact that it filters out Mondays. Mondays are filtered out because there is a natural tendency for the VIX to rise on Mondays. This tendency also exists (and is a bit stronger) on Tuesdays when Monday is a holiday, like now. So I decided to run the same test and filter to only include Mondays. If the results were still positive then that would provide me comfort in including this study on the Active List.

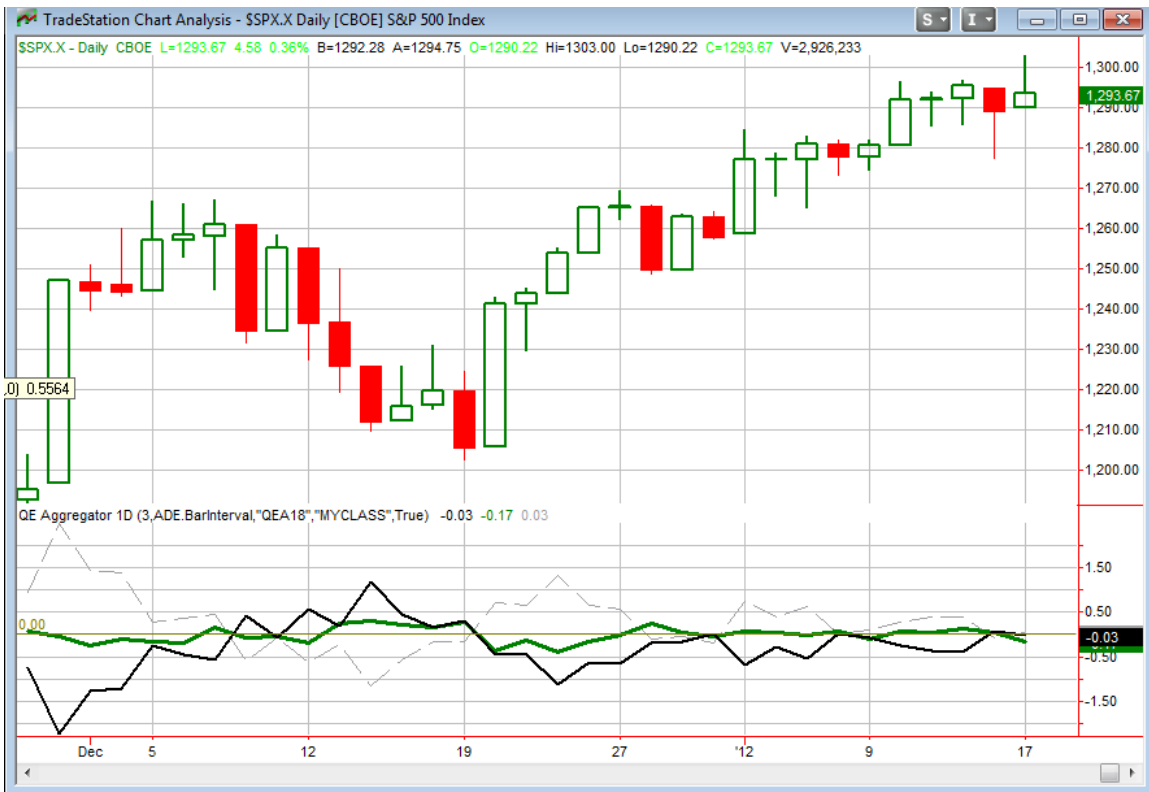
VIX closes up over 6% while SPY closes positive. Today *is* Monday.  
Buy SPY on close. Sell X days later. \$100k/trade. 1993 - present.

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	-14,752.20	13	5	8	38.46	1,334.22	2,143.20	-2,677.91	-10,971.48	0.50	0.31	-1,134.78
4	-13,079.88	13	6	7	46.15	1,025.81	2,252.64	-2,747.82	-8,255.66	0.37	0.32	-1,006.14
3	-8,545.64	13	6	7	46.15	891.62	2,362.10	-1,985.05	-4,912.28	0.45	0.39	-657.36
2	-6,732.17	13	5	8	38.46	924.00	1,858.87	-1,419.02	-3,302.96	0.65	0.41	-517.86
1	-4,173.38	13	5	8	38.46	296.67	538.75	-707.09	-1,955.70	0.42	0.26	-321.03

Unfortunately, results here suggest substantial risk and limited reward. With this in mind I decided to exclude this study from the Active List (and the Aggregator calculation) as well tonight.

This leaves us with the same 3 studies on the short-term Active List tonight, but with the bullish ones nearing expiration.

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



Without bullish studies emerging as it appeared was likely late afternoon the green Aggregator line dipped into negative territory. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the black Differential Line dipped a little below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are slightly bearish and the SPX is marginally overbought versus recent expectations. This is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close below 0. This caused the Aggregator System to turn from long to short.

Based on the current active studies, expectations are scheduled to remain negative on Wednesday. Of course this could change if more bullish evidence emerges. The Differential Pivot will be slightly inverted at 1,298.48 on Wednesday. This is 0.4% *above* Tuesday's close. So in order for the Differential Line to remain negative and the SPX to continue to remain "overbought" the SPX will need to gain at least this much. Otherwise overbought will turn to oversold and the Differential Line will flip back positive.

Like last night I am a bit wary of this signal. My reasons are:

- 1) The Aggregator value, while negative, is entirely due to seasonality. I am not as keen on seasonality studies as I am on those associated with breadth, volume, or price action.
- 2) The Differential reading is very close to 0 – suggesting only a very slight overbought reading.
- 3) The Differential Pivot is inverted. This limits reward since any profitable short position would trigger an exit on Wednesday. Only a move against the short position could keep Differential Line negative and the Aggregator System short.

With all this in mind I am again not inclined to take on new exposure. I believe a little patience will provide us with a higher reward/risk opportunity. I remain in "wait and see" mode.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 1/17 – somewhat bullish***

The most recent update to the intermediate-term outlook can be found in the 1/17 letter which can be downloaded using the link below.

[2012-01-17 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
<i>MO(1/3)</i>	<i>1/5/2012</i>	<i>\$28.40</i>	<i>\$29.09</i>	<i>2.43%</i>		<i>sold on open</i>

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