

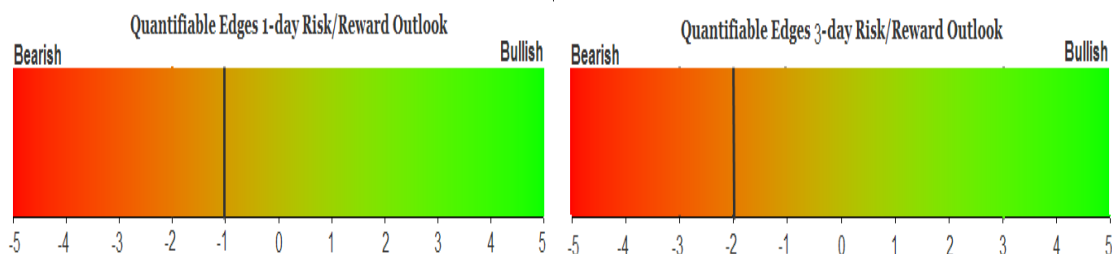
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 19, 2012

Volume 5 Issue 12

Market Overview



Signals Overview

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

Tonight's Research Points

- Strongly stretched conditions like we are experiencing used to suggest a bullish intermediate-term edge. In recent years it hasn't reliably suggested anything.

Short-term Outlook

The Bottom Line

Risk/reward appears to favor the bears. The edge isn't enormous, but it appears worth playing. I'm looking to profit from a short-term dip.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
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%
Active - Long Term				
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.

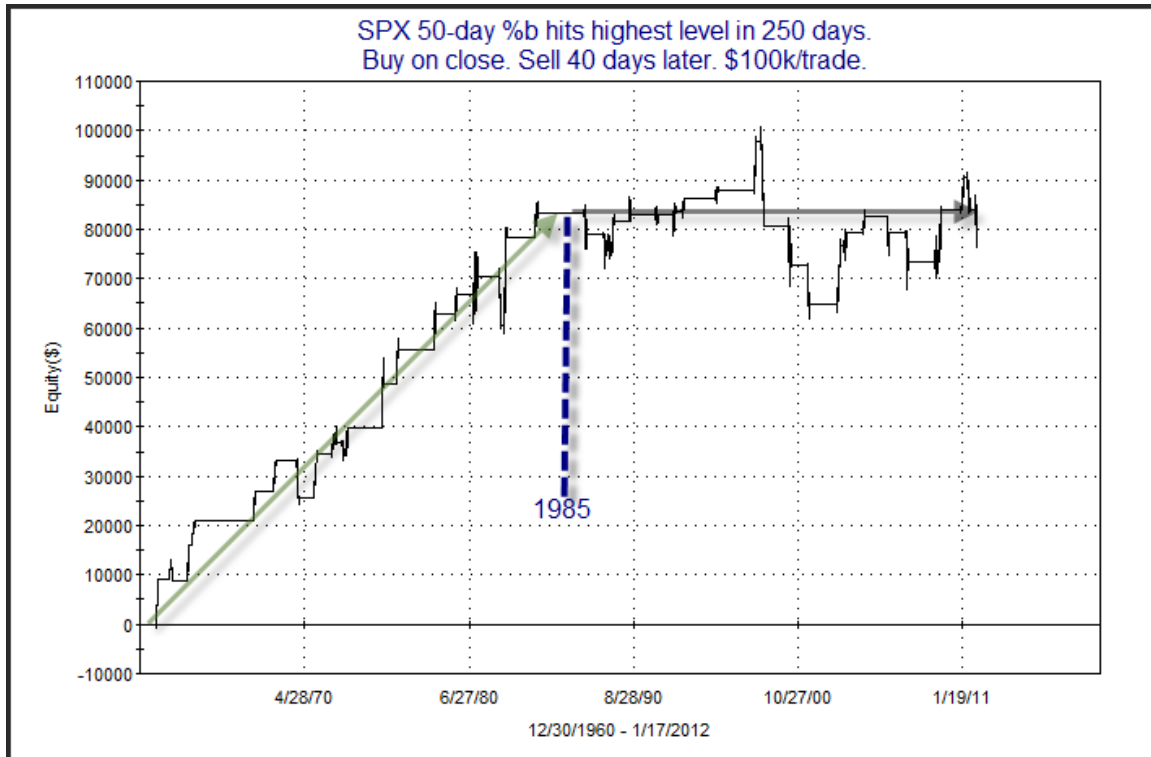
The Evidence

The march higher continued on Wednesday despite overbought conditions and weak seasonality. The SPX gained 1.1%, the Nasdaq rose 1.5%, and the Russell 2000 rallied 1.8%. Breadth was strongly positive as the NYSE Up Issues % came in at 78% and the Up Volume % was 85%. Total NYSE volume was just a smidge higher than Tuesday.

One study that did pop up in the Quantifinder was from the 12/13/10 subscriber letter. In that I looked at extreme stretches above the 50ma. I measured “extreme” by using the Bollinger %b calculation and looking for the highest reading in the last 250 trading days (about 1 yr). I have updated that study below.

SPX 50-day %b hits highest level in 250 days. Buy on close. Sell X days later. \$100k/trade.												
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
50	82,481.25	43	28	15	65.12	5,834.88	18,408.18	-5,393.02	-22,488.00	1.08	2.02	1,918.17
45	82,114.35	43	25	18	58.14	6,369.99	15,807.96	-4,285.29	-11,512.82	1.49	2.06	1,909.64
40	82,977.11	44	28	16	63.64	5,881.90	17,624.67	-5,107.26	-17,180.22	1.15	2.02	1,885.84
35	73,323.87	44	28	16	63.64	5,252.13	15,782.13	-4,608.49	-10,081.40	1.14	1.99	1,666.45
30	45,130.02	44	30	14	68.18	3,665.81	11,920.74	-4,631.73	-7,173.84	0.79	1.70	1,025.68
25	38,630.20	44	29	15	65.91	3,828.43	10,859.94	-4,826.28	-8,732.16	0.79	1.53	877.96
20	35,055.35	46	28	18	60.87	3,667.42	8,177.85	-3,757.36	-7,619.00	0.98	1.52	762.07
15	39,333.46	46	29	17	63.04	2,855.27	7,372.56	-2,557.03	-8,179.60	1.12	1.90	855.08
10	40,976.51	46	32	14	69.57	2,078.21	5,697.77	-1,823.29	-4,404.75	1.14	2.61	890.79
5	21,589.99	49	32	17	65.31	1,415.54	4,765.28	-1,394.55	-5,254.76	1.02	1.91	440.61

These results appear strong and seem to support the idea that such a strong stretch favors a continuation of a move higher. But they don't show how the edge has played out over time. To show that I have produced an equity curve below. I used 40-days since those results showed the most net gains.

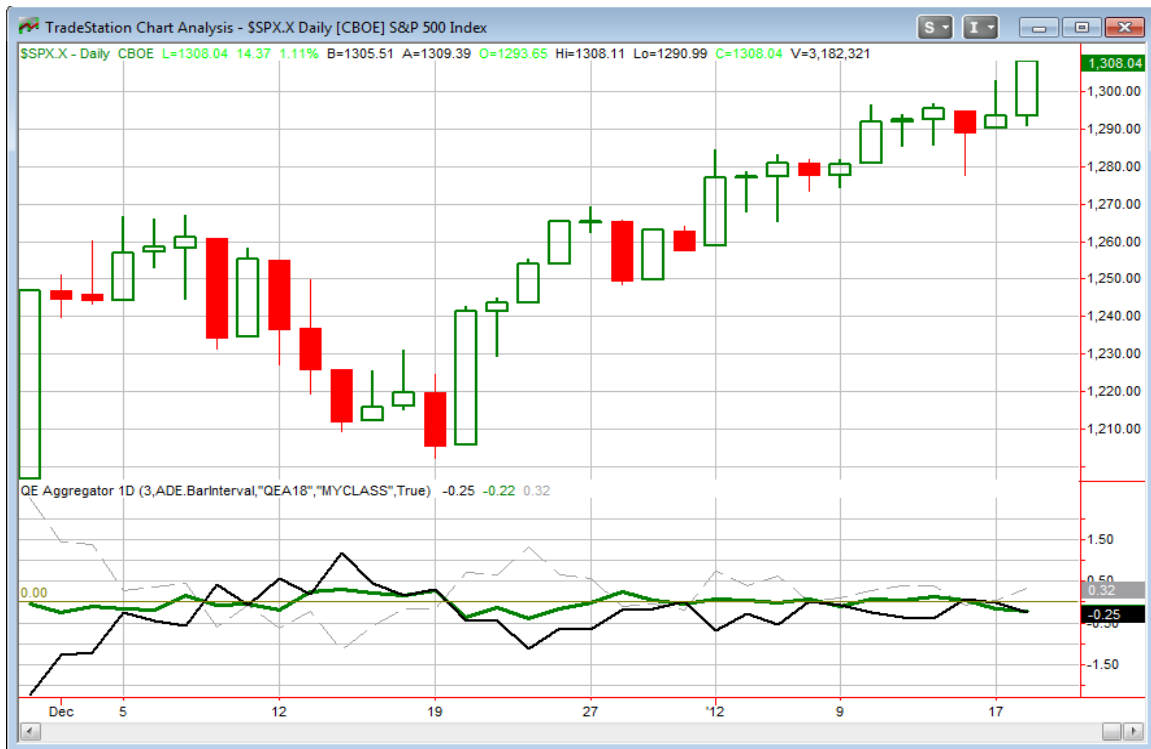


What's evident here is that during the 60s, 70s and early 80s the market tended to follow through on these very strong readings. Since then there has been neither a bullish nor bearish inclination. I actually looked at many different equity curves and they all looked similar to this. At one time such strong readings DID suggest an edge. It doesn't appear they do any longer.

Overbought in an uptrend can persist for a while and often lacks strong edges. With the short-term POMO count now bullish there is a risk that the move up may continue a while longer. Still, if the market is going to pull back, we are in an opportune time window for the next couple of days. Downside reward does seem a bit bigger than upside risk at the moment so perhaps it is worth taking a shot with a small position.

First let's look at the Aggregator.

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



With bullish forces expiring the green Aggregator line dipped further 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 is also below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are bearish and the SPX 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 remain short.

Based on the current active studies, expectations are scheduled to remain negative on Thursday. Of course this could change if bullish evidence emerges. The Differential Pivot will be 1,291.49 on Thursday. This is 1.3% below Wednesday's close. So it will take a drop of at least this much in order for the Differential Line to turn positive. That's not an impossible feat, but the SPX has not declined that much in a single day since 12/12/11. So a multi-day decline or consolidation appears more probable.

While evidence is still not overwhelming, risk/reward seems to favor the bears, and I think it is worth taking some short exposure. With my intermediate-term outlook somewhat bullish I am inclined to keep this position small and perhaps exit quickly should the market take a quick dive. This is a counter-trend trade so I am not going to get too aggressive with it.

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.

SPY – short ¼ index position @ \$130.77 limit. Based on short-term outlook above. I am looking to take on a small amount of short index exposure to try and take advantage of a possible dip.

Current Open Trade Ideas

None.

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