

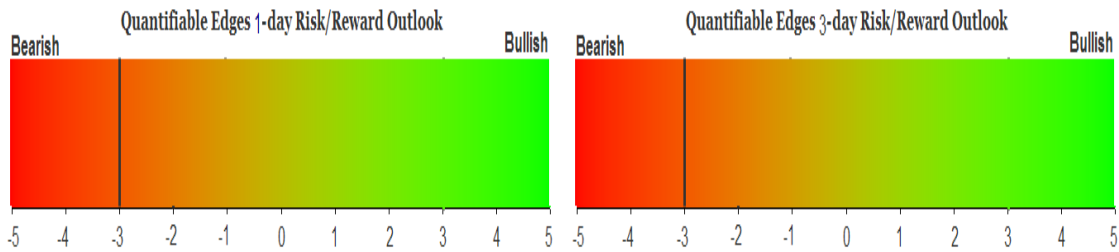
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 20, 2012

Volume 5 Issue 13

Market Overview



Signals Overview

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

Tonight's Research Points

- SPX at a 50-day while the VIX:VXV ratio is very low has suggest higher risk than potential reward the following day.
- When the SPX has closed near the top of its 2-week range on the day prior to options expiration there has often been a selloff over the last several years.

Short-term Outlook

The Bottom Line

A have a small short position and am looking to hold it another day.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
January 20, 2012	SPX 50-high. VIX:VXV < 0.85	1 day	Bearish	
January 20, 2012	Op-ex Thursday closes near high	1-4 days	Bearish	-1.60%
January 17, 2012	MLK/Jan opex week bearish	1-4 days	Bearish	
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	
Dropped Tonight				
January 12, 2012	Breakout then inside day	1-5 days	Bullish	1.50%

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

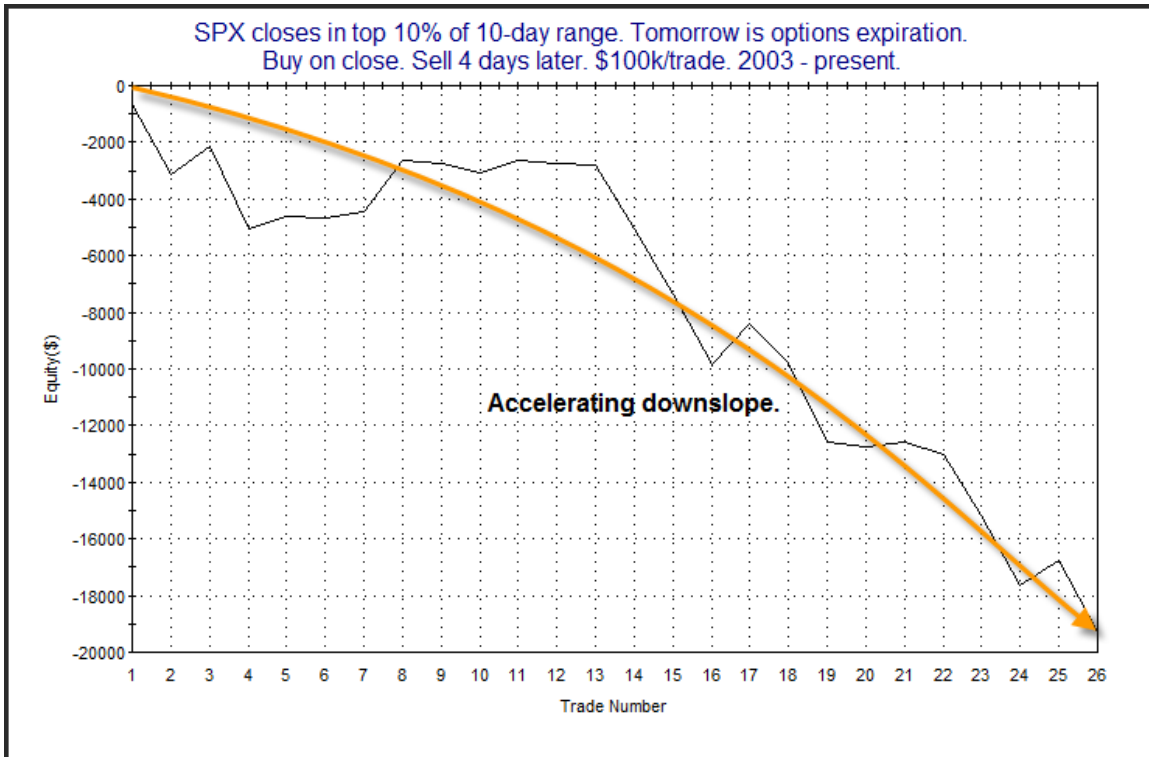
The Evidence

The market continued to grind higher on Thursday. The SPX rose 0.5%, the Nasdaq was up 0.7%, and the Russell 2000 rallied 0.4%. Breath was solidly positive as the NYSE Up Issues % came in at 67% and the Up Volume % was 66%. Total NYSE volume rose some for the 2nd day in a row.

Despite the negative seasonality that is typical during January op-ex and MLK week (which are often the same) the market has continued to rise and closed today at a new rally high. The study below was last seen in the 2/18/11 subscriber letter. It examined op-ex day performance when the SPX close in the top 10% of its 10-day range. Stats have been updated.

SPX closes in top 10% of 10-day range. Tomorrow is options expiration. Buy on close. Sell X days later. \$100k/trade. 2003 - 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	-18,865.90	26	8	18	30.77	1,042.23	3,768.30	-1,511.32	-4,932.90	0.69	0.31	-725.61
4	-19,308.74	26	8	18	30.77	794.80	1,825.60	-1,425.95	-2,899.20	0.56	0.25	-742.64
3	-9,572.61	26	13	13	50.00	606.72	1,474.40	-1,343.08	-2,828.70	0.45	0.45	-368.18
2	-10,003.29	26	14	12	53.85	459.26	1,588.40	-1,369.41	-3,784.65	0.34	0.39	-384.74
1	-4,074.11	26	13	13	50.00	389.30	2,286.84	-702.69	-2,875.60	0.55	0.55	-156.70

The numbers here are fairly compelling. To confirm the downside edge I also produced a profit curve. The curve is based on a 4-day exit strategy.



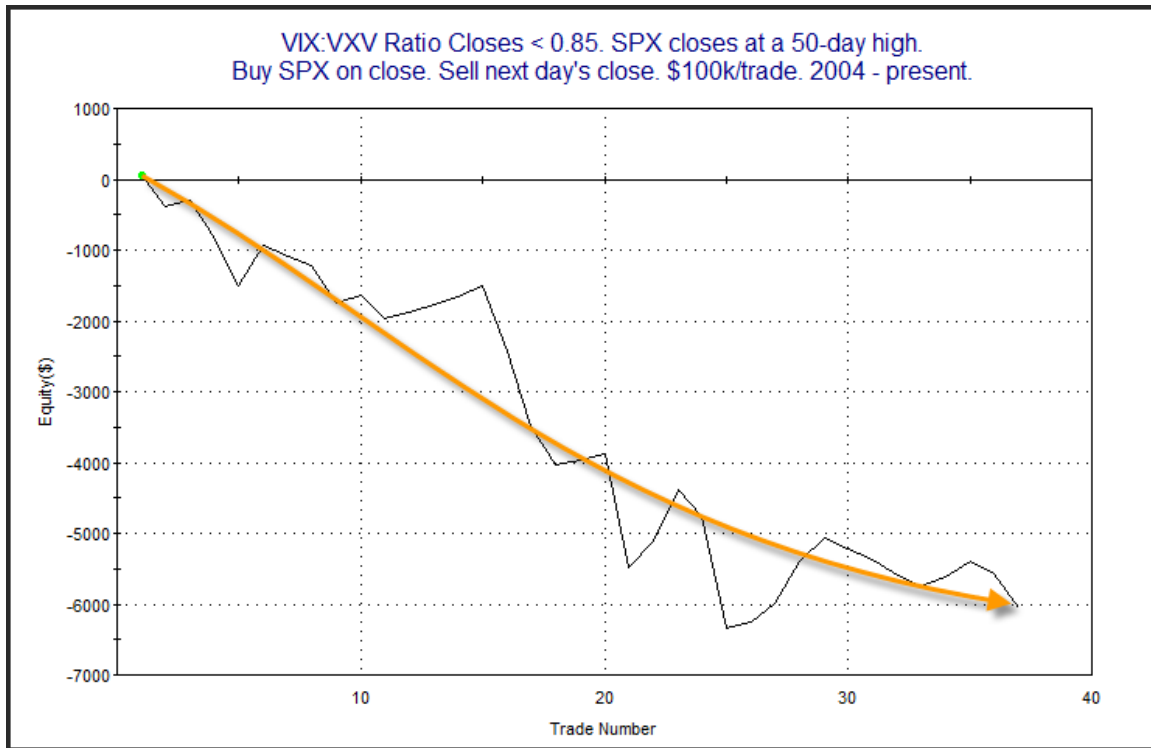
The curve would seem to confirm the downside edge suggested by the stats table.

The Quantifinder also noted the study below which was seen last week in the 1/13/12 letter. It examined instances of the SPX closing at a 50-day high while the VIX:VXV ratio was below 0.85. It showed a moderate 1-day downside edge. I have updated the results below.

VIX:VXV Ratio Closes < 0.85. SPX closes at a 50-day high.
Buy SPX on close. Sell next day's close. \$100k/trade. 2004 - present.

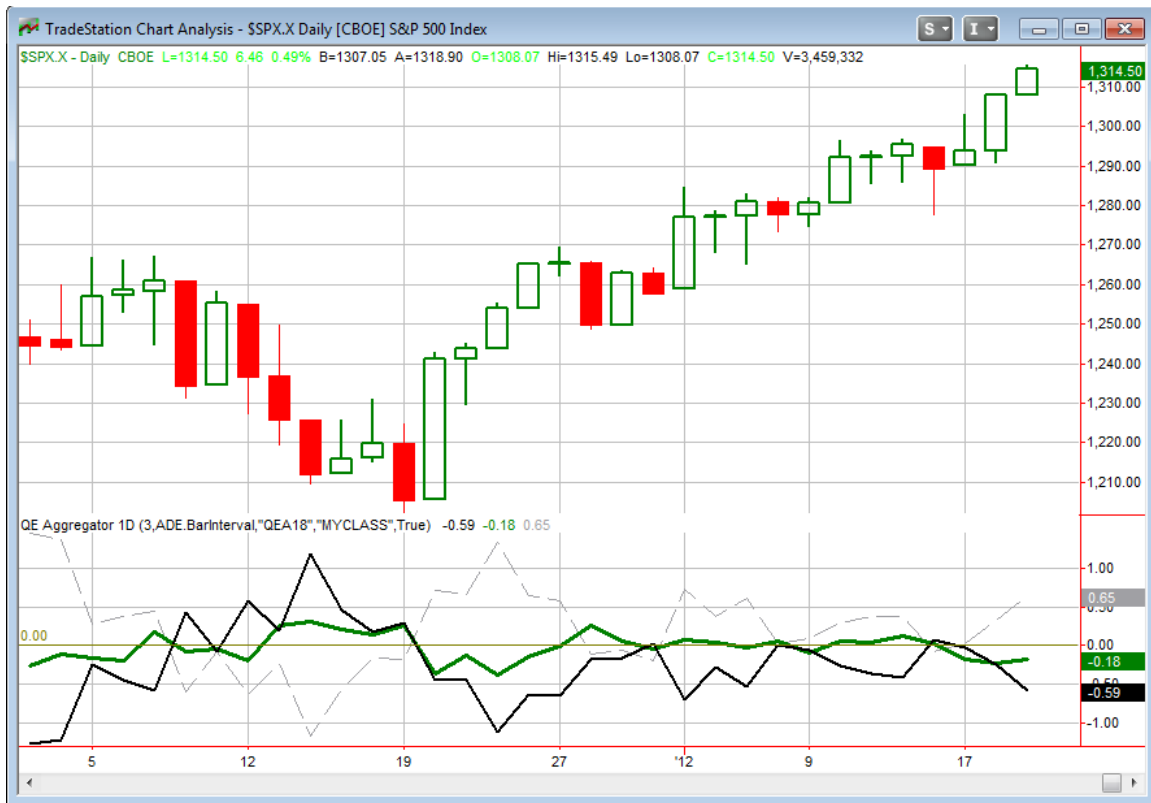
TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	(\$6,054.96)	Profit Factor	0.41
Gross Profit	\$4,146.49	Gross Loss	(\$10,201.45)
Total Number of Trades	37	Percent Profitable	48.65%
Winning Trades	18	Losing Trades	19
Even Trades	0		
Avg. Trade Net Profit	(\$163.65)	Ratio Avg. Win:Avg. Loss	0.43
Avg. Winning Trade	\$230.36	Avg. Losing Trade	(\$536.92)
Largest Winning Trade	\$708.05	Largest Losing Trade	(\$1,602.28)

The odds are 50/50 but the losers have been more than twice the size of the winners. This suggests the complacency we are seeing at these high levels is more likely to lead to a big down day than be followed by a big up day. To see how the edge has played out over time I have posted the profit curve below.



The equity curve seems to have flattened out a bit lately. I noted last week that I was going to keep an eye on this one, and I will continue to do so. For now I find it compelling enough to include on the Active List.

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



The last of the short-term bullish studies expired today and everything is pointing south over the next 3 days. This left the green Aggregator line solidly in 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 Friday. Of course this could change if bullish evidence emerges. The Differential Pivot will be 1,293.21 on Friday. This is 1.6% below Thursday'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 12/8/11. So a multi-day decline or consolidation appears more probable.

I entered the short position at the open on Thursday. Evidence is a bit more bearish at this point, but we are just barely above the entry price, and I'm not inclined to bet aggressively against my intermediate-term outlook (and the trend). I'm planning on holding my current position but not adding any more just yet.

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. There were quite a few new securities that appeared on the triggers spreadsheet. I'll probably choose one or two tomorrow night if we continue to press overbought. Traders looking for ideas could look there.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	1/19/2012	\$131.22	\$131.46	-0.18%		shorted on open

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