

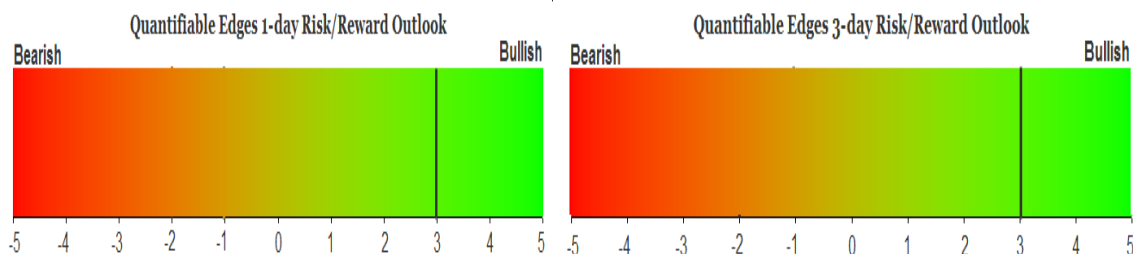
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 31, 2012

Volume 5 Issue 20

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Long	100% Long XIV	Flat	Long

Tonight's Research Points

- 3 down days prior to a possible “Turnaround Tuesday” has been short-term bullish in the past.
- The 1st dip below the 10ma for SPY after spending at least 25 days above it has always been buyable.

Short-term Outlook

The Bottom Line

Though mild, the pullback is now at a point where an upside edge seems apparent. I am partially long and will consider adding to my position if the pullback deepens.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
January 31, 2012	SPX 1st close < 10ma in under 25 days	1-4 days	Bullish	1.80%
January 31, 2012	SPY 3-day pullback. Today is Monday.	1-4 days	Bullish	2.30%
January 30, 2012	SPX down. Up Issues % > 55%.	1-2 days	Bullish	
January 26, 2012	SPX 100-day high on Fed Day	1-6 days	Bullish	1.60%
Active - Long Term				
January 31, 2012	SPX 1st close < 10ma in under 25 days	1-20 days	Bullish	4.70%
January 17, 2012	Nasdaq leading SPX	int term	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

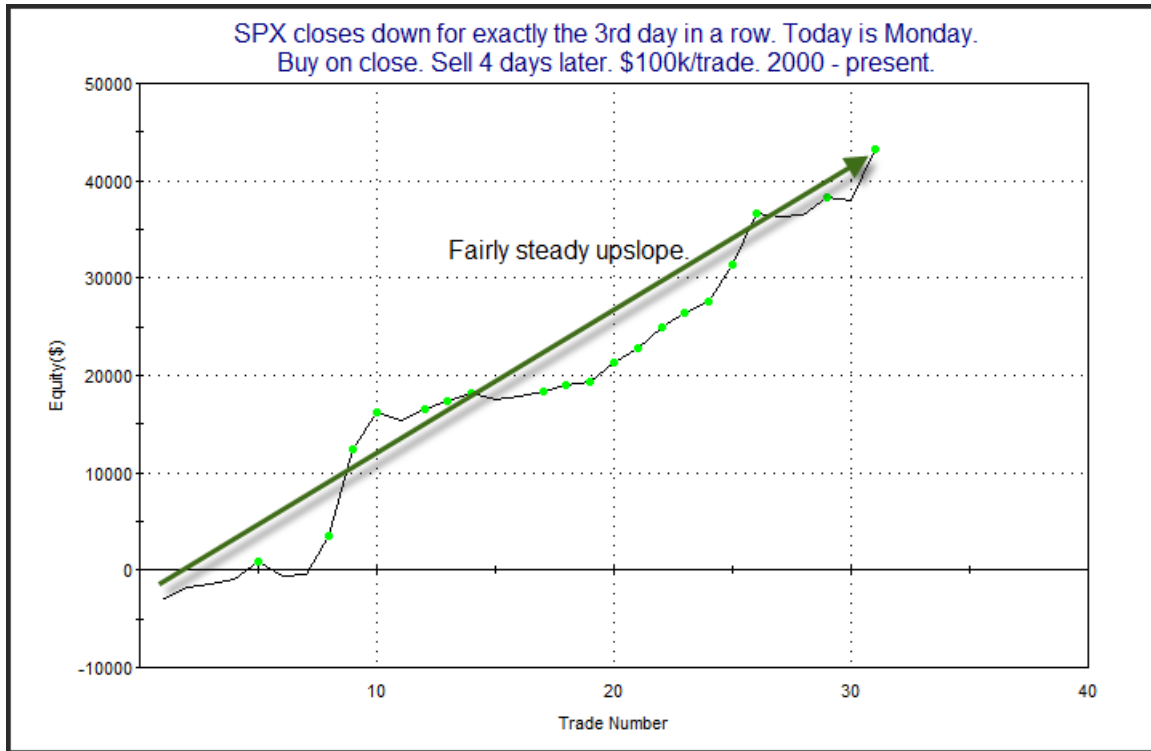
A weak open never worsened Monday and the market spent most of the day trying to win back its losses. It didn't quite get there in the end, but losses finished relatively mild. The SPX closed down 0.25%, the Nasdaq dropped 0.2% and the Russell 2000 lost 0.8%. Breadth was negative as the NYSE Up Issues % came in at 37% and the Up Volume % was 29%. Total NYSE volume was down and pretty light.

Pullbacks of 3 days will typically trigger some studies. On its own, there is very little edge in buying 3-day pullbacks, but when these pullbacks have certain characteristics they often become compelling buys. The simple fact that the pullback has reached day-3 on a Monday seems to increase the likelihood of a bounce. I've shown before that of all days Tuesday has historically shown the highest propensity to halt a short-term pullback. The study below is one from the larger [Turnaround Tuesday study](#). It was last published in the 4/12/11 Subscriber Letter.

SPX closes down for exactly the 3rd day in a row. Today is Monday. Buy on close. Sell X days later. \$100k/trade. 2000 - 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	57,943.26	30	24	6	80.00	2,850.96	13,815.90	-1,746.63	-4,387.46	1.63	6.53	1,931.44
9	62,370.50	30	24	6	80.00	2,805.27	11,206.23	-825.98	-1,686.96	3.40	13.59	2,079.02
8	59,848.55	30	24	5	80.00	2,735.16	11,382.35	-1,159.07	-2,031.30	2.36	11.33	1,994.95
7	59,233.96	30	25	5	83.33	2,613.48	11,104.17	-1,220.59	-2,148.96	2.14	10.71	1,974.47
6	47,989.06	30	22	8	73.33	2,499.82	10,034.53	-875.87	-1,676.79	2.85	7.85	1,599.64
5	54,949.21	31	22	9	70.97	2,820.76	9,572.31	-789.72	-1,714.92	3.57	8.73	1,772.56
4	43,260.03	31	25	6	80.65	1,992.67	8,810.76	-1,092.79	-2,964.25	1.82	7.60	1,395.48
3	38,297.99	31	22	9	70.97	2,041.41	8,432.34	-734.78	-1,873.02	2.78	6.79	1,235.42
2	26,541.93	31	24	7	77.42	1,343.40	5,018.23	-814.23	-1,590.28	1.65	5.66	856.19
1	18,993.51	31	21	10	67.74	1,301.04	4,723.23	-832.83	-2,680.15	1.56	3.28	612.69

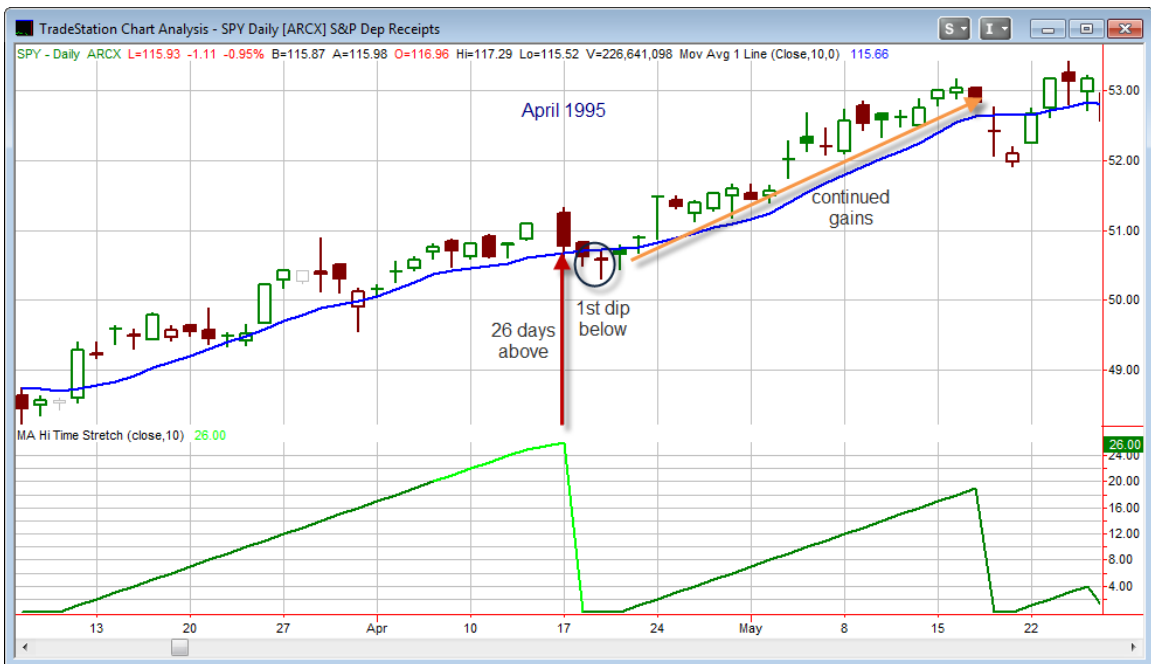
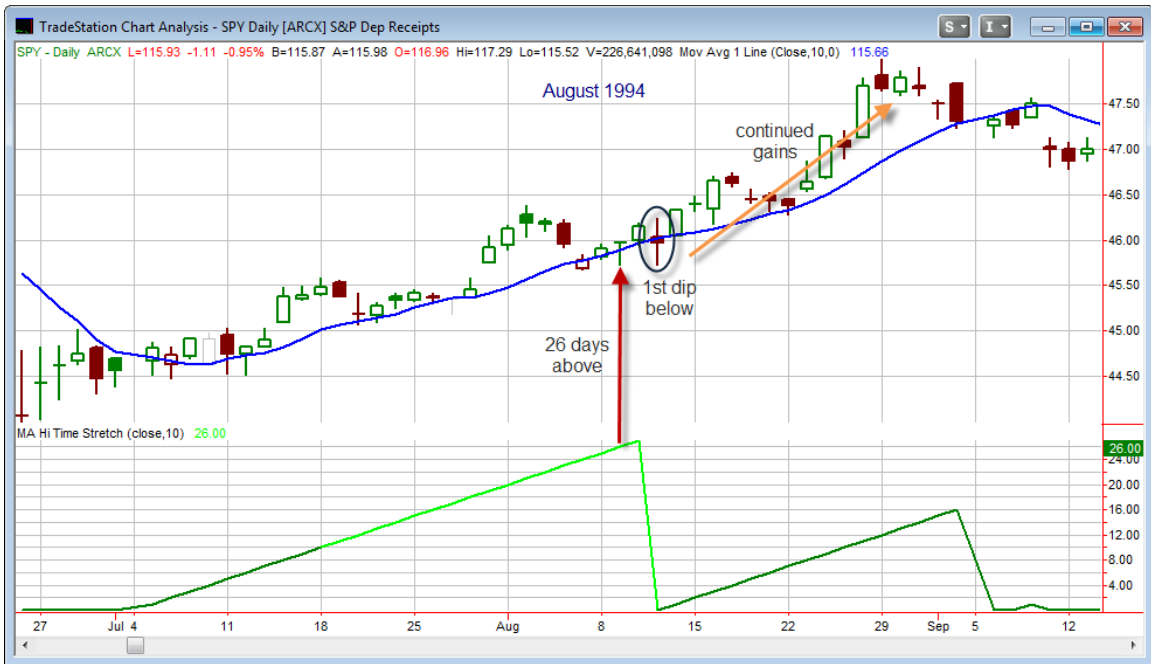
28 of 31 instances (90%) posted a close above entry price at some point in the next week. All 31 did within 7 trading days.

As you can see the market has strongly favored a quick move higher. And when that move hasn't happened on Tuesday it has often happened in the next few days. Below is an equity curve showing a 4-day exit strategy.

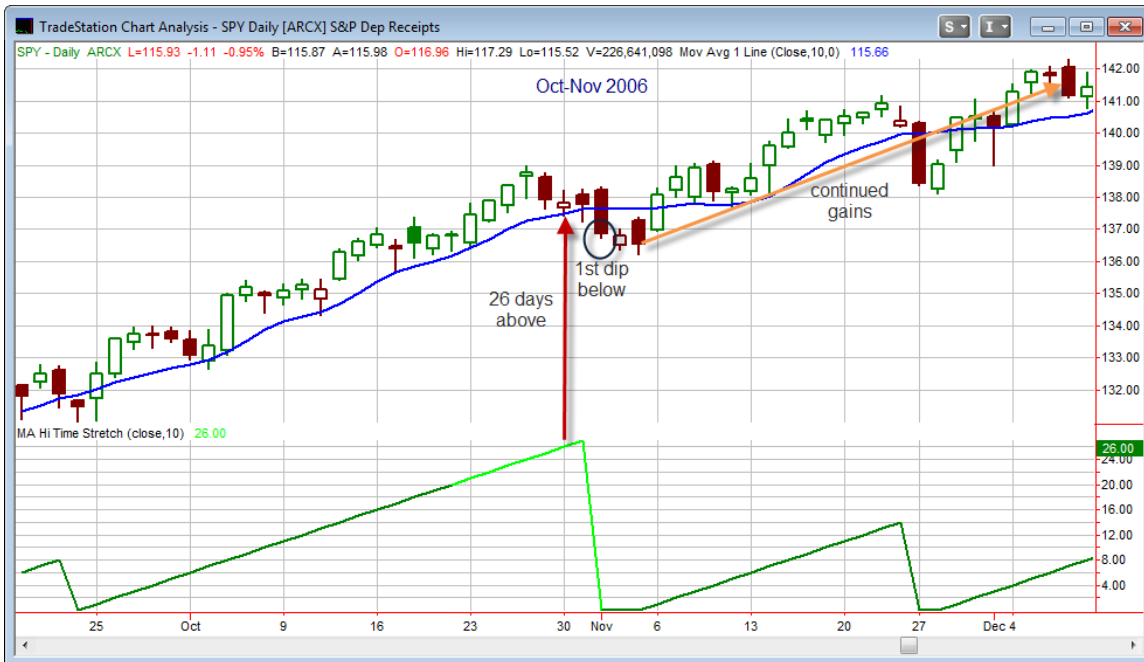


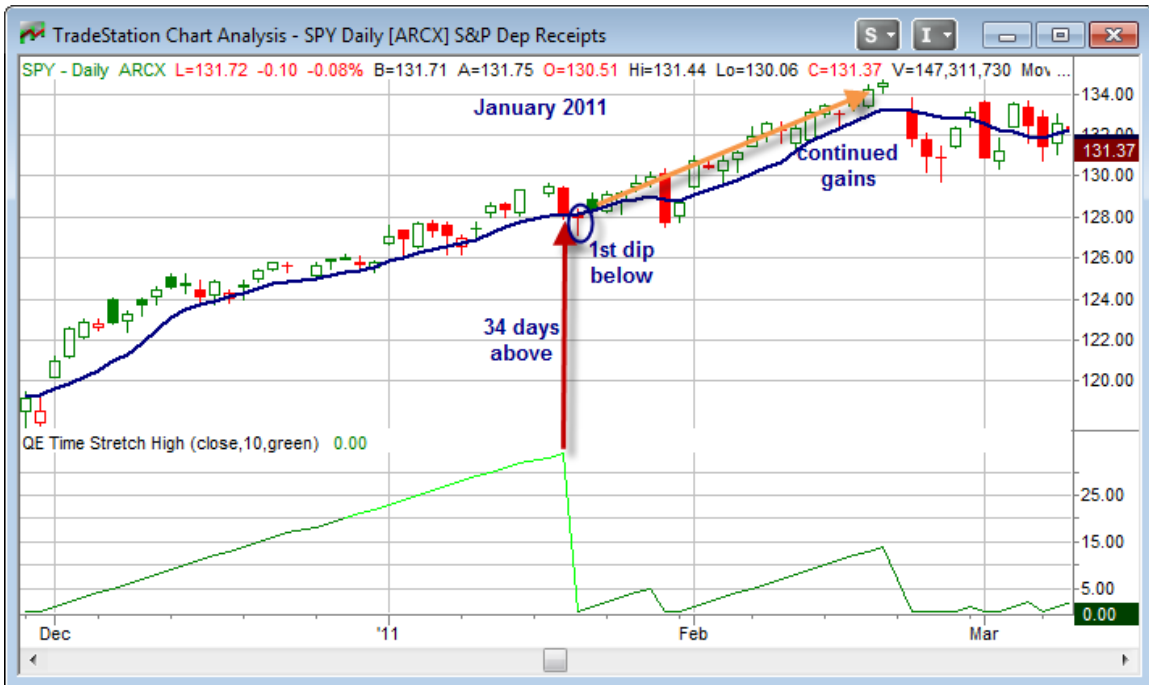
While the strength of the edge has oscillated some it has provided fairly consistent results over time. Certainly this study seems to suggest an upside edge.

Also notable about Monday's action is that the SPY closed below its 10ma for the first time since December 19th. In the 1/21/11 Subscriber Letter I looked at all the instances where SPY had traded above its 10ma for at least 25 days then closed below it. Since its inception in 1993 there were only seven other instances (now eight) where SPY had a run of 25 days or more. I showed the charts of every instance and noted how the market reacted after it finally did close beneath its 10ma. I noted that the first dip never had resulted in the end of the rally. Below I have republished those 6 charts and added a 7th one to show the Jan. 2011 instance. The indicator in the bottom pane of each chart shows the number of days the SPY has closed above its 10ma.









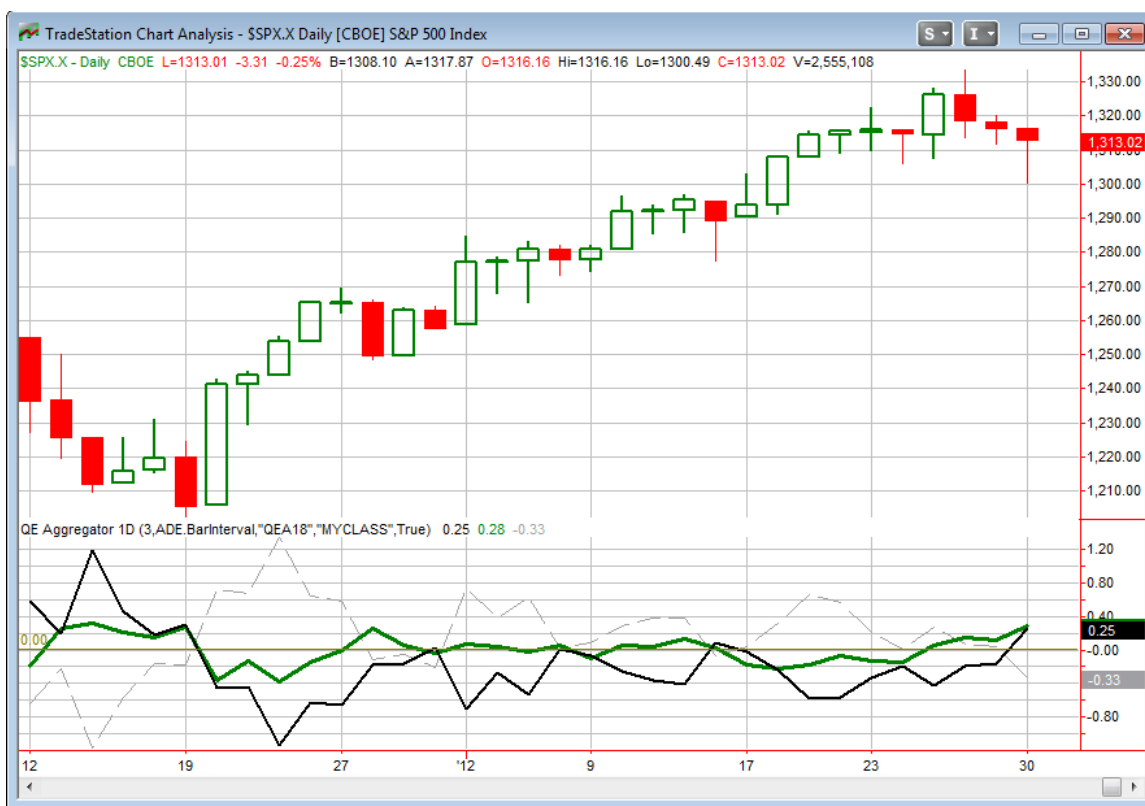
These charts all looked eerily similar. A brief examination is all that's needed to see that the first trip below the 10ma was a short one, and the uptrend quickly reasserted itself. Of course if you've been reading Quantifiable Edges for any period of time, you're probably used to looking at numbers. So below you will find the stats table.

After closing above the 10ma for at least 25 days in a row SPY closes below it today.
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
20	27,880.19	7	7	0	100.00	3,982.88	7,915.86	0.00	0.00	100.00	100.00	3,982.88
19	27,835.45	7	7	0	100.00	3,976.49	6,866.19	0.00	0.00	100.00	100.00	3,976.49
18	23,064.36	7	7	0	100.00	3,294.91	5,903.19	0.00	0.00	100.00	100.00	3,294.91
17	22,252.87	7	7	0	100.00	3,178.98	5,537.25	0.00	0.00	100.00	100.00	3,178.98
16	23,935.96	7	7	0	100.00	3,419.42	5,662.44	0.00	0.00	100.00	100.00	3,419.42
15	23,827.27	7	7	0	100.00	3,403.90	6,047.64	0.00	0.00	100.00	100.00	3,403.90
14	24,093.64	7	7	0	100.00	3,441.95	6,115.05	0.00	0.00	100.00	100.00	3,441.95
13	26,203.22	7	7	0	100.00	3,743.32	6,500.25	0.00	0.00	100.00	100.00	3,743.32
12	23,657.50	7	7	0	100.00	3,379.64	5,604.66	0.00	0.00	100.00	100.00	3,379.64
11	22,113.82	7	7	0	100.00	3,159.12	5,845.41	0.00	0.00	100.00	100.00	3,159.12
10	18,989.71	7	7	0	100.00	2,712.82	5,325.39	0.00	0.00	100.00	100.00	2,712.82
9	16,811.66	7	7	0	100.00	2,401.67	4,882.41	0.00	0.00	100.00	100.00	2,401.67
8	14,153.25	7	7	0	100.00	2,021.89	4,574.25	0.00	0.00	100.00	100.00	2,021.89
7	10,927.28	7	7	0	100.00	1,561.04	4,304.61	0.00	0.00	100.00	100.00	1,561.04
6	8,323.08	7	5	2	71.43	1,754.29	3,158.64	-224.19	-280.80	7.83	19.56	1,189.01
5	10,348.47	7	6	1	85.71	1,801.18	3,466.80	-458.64	-458.64	3.93	23.56	1,478.35
4	10,195.75	7	7	0	100.00	1,456.54	3,158.64	0.00	0.00	100.00	100.00	1,456.54
3	7,406.49	7	7	0	100.00	1,058.07	2,744.55	0.00	0.00	100.00	100.00	1,058.07
2	4,012.62	7	6	1	85.71	707.70	1,656.36	-233.60	-233.60	3.03	18.18	573.23
1	3,557.40	7	5	2	71.43	742.91	1,974.15	-78.57	-98.75	9.45	23.64	508.20

Strong and persistent upside movement like we have seen lately hasn't just ended and lead to an immediate correction. The 1st dip has always been just that – a dip. New highs were always made in short order. After these new highs were made there may have been a loss of momentum that turned into a substantial top. It never came on the 1st dip, though – and the 1st dip is where we are now. The caveat here is obviously the low sample size. But with every instance positive not just for a day or 2, but for 16 of the next 20 days, I find these results very compelling. (In fact all 7 remain positive through day 27.) I have decided to include this study on both the short and intermediate-term Active List.

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



Additional bullish evidence today has pushed the green Aggregator line into strongly positive territory. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line spiked above 0. A positive Differential reading means the SPX has underperformed expectations over the last few days. So net expectations are bullish and the SPX is oversold versus recent

expectations. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. This caused the Aggregator System to flip from flat to long at the close. This was indicated as likely in last night's letter and while on the road I sent a tweet as a reminder before the close.

Based on the current active studies, expectations are scheduled to remain positive on Tuesday. This could change if strong bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,319.13 on Tuesday. This means the SPX will need to rise about 0.5% in order to turn the Differential Line negative.

So there are a few things to consider here. For one, we are seeing some compelling evidence that the market is primed to bounce (and perhaps do more than just bounce). I got partially long at the close (and the SPY trade idea from last night just barely filled). The evidence is compelling enough that I considered getting quickly aggressive. But the "pullback" is about as mild as it could have been to still be considered a pullback. On a closing basis the SPX really hasn't done much other than go sideways for 7 days. So while I considered taking more at the open, I ultimately decided to look for more of a pullback before getting too aggressive. Evidence is strong, but if the bullish inclinations don't kick in as they normally do right away, we could see a mini-breakdown before the bounce ensues.

The 2nd thing to consider is that the Differential Pivot is not far away (only 0.5%). But while the Aggregator signal could quickly turn flat, the short-term evidence is suggesting a bounce closer to 2%. Additionally, intermediate-term evidence is continuing to strengthen, so we could get a decent move up from here. Therefore, rather than simply take a quick profit as I often do when an Aggregator signal turns flat, I will likely take partial profits on my position and then try and ride the remaining for a bit more.

Intermediate-term Outlook (2 weeks – 2 months)– updated 1/30 – bullish

The intermediate-term outlook was last updated in the 1/30/12 letter. A link is below:

[2012-01-30 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 – buy ¼ index position @ \$130.25 LIMIT ON CLOSE. Based on the short-term outlook above I will look to add another lot to my position if it closes down near the lower end of Monday's range.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
<i>DIA(s)</i>	<i>1/23/2012</i>	<i>\$126.96</i>	<i>\$126.23</i>	<i>0.57%</i>		<i>covered on close</i>
SPY(1/4)	1/30/2012	\$131.37	\$131.37	0.00%		bought on close

I will sell ½ of my SPY position on an SPX close \geq 1,319.13.

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