

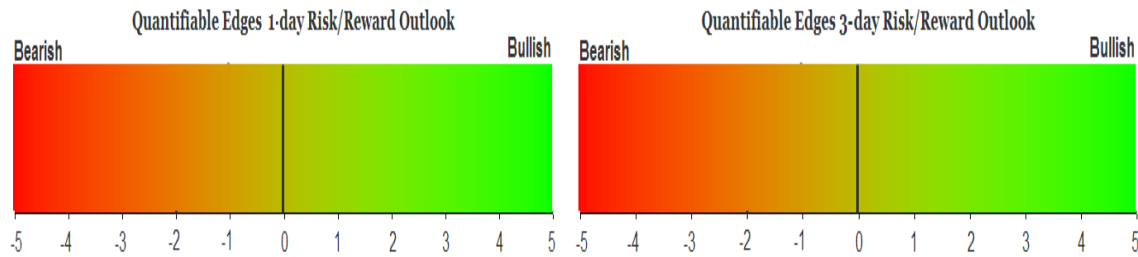
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 7, 2012

Volume 5 Issue 25

## Market Overview



## Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Flat	50% Long XIV	Flat	Flat

## Tonight's Research Points

- The extremely low range suggests bearish implications.
- Low volume on a down day after a 50-day high is often followed by more selling.
- An unfilled gap up and 20-day high followed by an unfilled gap down appears short-term bearish.
- A down day that keeps the RSI(2) > 90 is rare and has been followed by upside in the past.

## *Short-term Outlook*

### *The Bottom Line*

Expectations have been dampened and are on the verge of turning negative. I'm not ready to try a counter-trend short-trade just yet, but it could happen in the next few days.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
February 7, 2012	60-day low SPY range > 200ma	1-6 days	Bearish	
February 7, 2012	Low vol drop from 50-high	1-6 days	Bearish	
February 7, 2012	Unfill Gap Up 20-high then unfill gap dn	1-6 days	Bearish	
February 7, 2012	RSI(2) > 90 on down day > 200ma.	1-2 days	Bullish	
February 6, 2012	Up Issues % > 75% 2 of 3. 10 high.	1-6 days	Bullish	2.60%
<b>Active - Long Term</b>				
February 6, 2012	Up Issues % > 75% 2 of 3. 10 high.	1-16 days	Bullish	4.70%
February 2, 2012	50-high then 5-day consolidation	1-10 days	Bullish	2.30%
February 1, 2012	Golden Cross	int term	Bullish	
January 31, 2012	SPY 1st close < 10ma in over 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 slight dip on Monday drew very little action. It started with a moderate sized gap down, and while the market nearly fought its way back to breakeven by the bell it didn't quite make it. The SPX finished down 0.04%, the Nasdaq lost 0.1% and the Russell 2000 dropped 0.3%. Breadth was slightly negative as the NYSE Up Issues % came in at 42% and the Up Volume % was 47%. Total NYSE volume dipped to the lowest level of 2012.

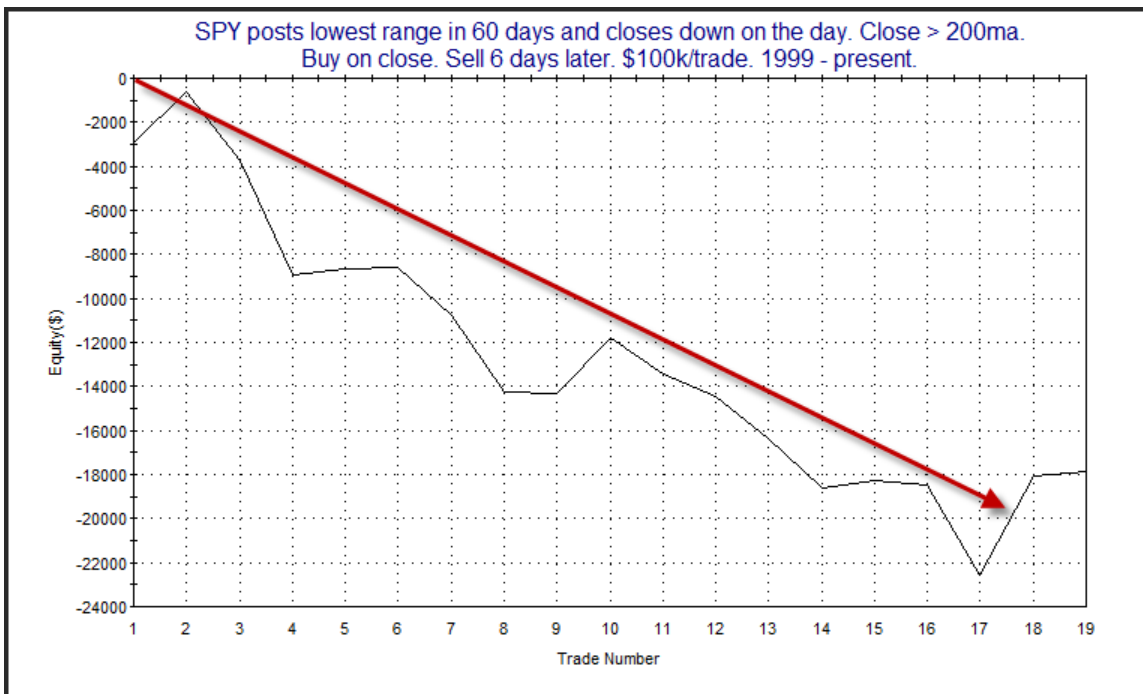
The market was down a little and no one seemed to care. Volume was extremely light, and the range was the lowest in months. This kind of indifference can sometimes mean that bulls are done (temporarily). They pushed prices higher leading up to today and now there is a buying strike. Often this kind of action will be followed by sellers entering the market to fill the vacuum that is being created with the buyers leaving. A number of studies triggered tonight that exemplify this concept. Again, it can be seen either by lack of volume or by lack of range. And Monday we had both.

This first study examined instances of extremely low range and a down close during a long-term uptrend. It was last seen in the 4/1/11 subscriber letter and has been updated below.

SPY posts lowest range in 60 days and closes down on the day. Close > 200ma.  
Buy on close. Sell X days later. \$100k/trade. 1999 - 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	-10,757.22	18	8	10	44.44	1,403.93	4,970.16	-2,198.87	-4,712.76	0.64	0.51	-597.62
9	-14,809.47	18	6	12	33.33	1,885.23	4,821.48	-2,176.74	-5,335.20	0.87	0.43	-822.75
8	-16,709.61	19	7	12	36.84	1,522.17	3,738.24	-2,280.40	-5,238.87	0.67	0.39	-879.45
7	-15,906.27	19	6	13	31.58	1,567.48	3,993.12	-1,947.01	-4,177.92	0.81	0.37	-837.17
6	-17,890.29	19	7	12	36.84	1,460.53	4,481.64	-2,342.83	-5,213.56	0.62	0.36	-941.59
5	-16,945.30	20	7	13	35.00	1,587.64	4,173.66	-2,158.37	-5,894.24	0.74	0.40	-847.26
4	-13,742.19	20	6	14	30.00	1,718.31	3,748.86	-1,718.00	-6,567.44	1.00	0.43	-687.11
3	-8,425.94	20	7	13	35.00	962.45	2,101.88	-1,166.39	-4,248.64	0.83	0.44	-421.30
2	-3,285.38	20	13	7	65.00	585.05	1,529.28	-1,555.87	-4,091.56	0.38	0.70	-164.27
1	-2,820.30	20	9	11	45.00	517.45	1,062.00	-679.76	-2,101.88	0.76	0.62	-141.01

Such extremely low range on a day the SPY dips a little has commonly been followed by a further drop. Below is the profit curve which shows how this edge has played out over time using a 6-day exit strategy.



Despite the last 2 trades the downslope has been pretty steady. I'll keep an eye to see if the curve changes but at this point it still appears to suggest a downside edge.

Light volume pullbacks are often regarded as bullish by many analysts. Yet in my research I have found that when a pullback begins on very light volume the pullback has a good chance of deepening. Monday's action triggered the study below which was last seen in the 2/3/11 subscriber letter. I have updated the results.

After closing at a 50-day high yesterday, SPX declines today. NYSE volume is the lightest in 10 days. Buy on close. Sell X days later. \$100k/trade. 1970 - 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	-21,088.52	58	31	27	53.45	1,760.92	5,104.00	-2,802.86	-6,121.74	0.63	0.72	-363.60
9	-16,315.99	59	31	28	52.54	1,787.76	3,955.23	-2,562.02	-6,236.87	0.70	0.77	-276.54
8	-26,540.51	59	29	30	49.15	1,541.41	3,521.07	-2,374.72	-6,661.66	0.65	0.63	-449.84
7	-35,708.29	59	28	31	47.46	1,344.09	3,732.48	-2,365.90	-7,193.64	0.57	0.51	-605.23
6	-36,651.21	60	27	33	45.00	1,155.74	2,563.47	-2,056.25	-5,426.99	0.56	0.46	-610.85
5	-25,777.98	61	28	33	45.90	978.77	2,273.04	-1,611.62	-4,288.68	0.61	0.52	-422.59
4	-20,220.20	63	31	32	49.21	901.80	2,457.84	-1,505.50	-4,263.60	0.60	0.58	-320.96
3	-3,890.39	64	35	29	54.69	887.06	2,169.48	-1,204.75	-3,726.24	0.74	0.89	-60.79
2	-1,254.18	64	33	31	51.56	777.36	2,328.05	-867.97	-4,049.40	0.90	0.95	-19.60
1	-3,762.02	64	33	31	51.56	545.83	2,235.13	-702.40	-3,068.81	0.78	0.83	-58.78

These results suggest a mild bearish edge over the 1<sup>st</sup> 6-7 days. The edge is not the most reliable as the “% Profitable” is close to a coin toss. The edge lies in the fact that downside risk has strongly outsized reward. Since it doesn't appear to be terribly reliable, I also ran a chart using a 6-day exit to see how the edge has played out over time.



Even without the real high percentage, the edge has been nicely consistent over the last 40 years. It certainly seems worthy of inclusion among the active studies.

Another study that triggered was from the 7/11/11 letter. It examined times SPY posted an unfilled gap down immediately after an unfilled gap up and a 20-day high. Results are updated.

SPY posts an unfilled gap down after an unfilled gap up. Yesterday was the highest close in 20 days. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1999 - 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	-15,515.47	12	2	10	16.67	1,035.72	1,937.52	-1,758.69	-3,349.00	0.59	0.12	-1,292.96
9	-18,669.27	12	2	10	16.67	1,068.93	2,070.90	-2,080.71	-4,281.25	0.51	0.10	-1,555.77
8	-14,513.48	12	2	10	16.67	1,248.08	1,846.26	-1,700.96	-6,802.05	0.73	0.15	-1,209.46
7	-13,043.30	12	2	10	16.67	1,685.09	1,818.18	-1,641.35	-3,808.60	1.03	0.21	-1,086.94
6	-14,077.92	12	2	10	16.67	1,079.35	1,790.10	-1,623.66	-3,425.00	0.66	0.13	-1,173.16
5	-9,268.00	12	3	9	25.00	763.50	1,649.70	-1,284.28	-4,404.92	0.59	0.20	-772.33
4	-8,992.35	12	5	7	41.67	556.59	1,045.98	-1,682.19	-3,746.95	0.33	0.24	-749.36
3	-6,170.44	12	4	8	33.33	488.04	844.11	-1,015.33	-2,017.28	0.48	0.24	-514.20
2	-5,665.09	13	4	9	30.77	285.95	774.00	-756.54	-2,232.00	0.38	0.17	-435.78
1	-1,687.22	13	6	7	46.15	523.00	941.70	-689.32	-1,807.92	0.76	0.65	-129.79

All 13 instances posted a close below the entry price at some point in the next week.

Instances are a bit low, but the consistency is very strong. Below I have listed all instances with a 6-day holding period.

SPY posts an unfilled gap down after an unfilled gap up. Yesterday was the highest close in 20 days. Close > 200ma. Buy on close. Sell 6 days later. \$100k/trade. 1999 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
01/07/99	Buy	\$126.81	(1.92%)	\$1,331.72
01/15/99	Sell	\$124.38		(\$5,066.84)
05/14/99	Buy	\$133.78	(2.01%)	\$1,352.07
05/24/99	Sell	\$131.09		(\$2,405.34)
12/06/99	Buy	\$142.78	(1.42%)	\$371.00
12/14/99	Sell	\$140.75		(\$2,380.00)
01/18/00	Buy	\$145.81	(3.43%)	\$815.15
01/26/00	Sell	\$140.81		(\$4,664.85)
03/20/02	Buy	\$115.24	(0.62%)	\$606.90
03/28/02	Sell	\$114.52		(\$1,681.98)
09/09/03	Buy	\$103.00	0.37%	\$766.30
09/17/03	Sell	\$103.38		(\$1,600.50)
03/17/06	Buy	\$130.62	(0.46%)	\$283.05
03/27/06	Sell	\$130.02		(\$895.05)
07/05/06	Buy	\$127.07	(2.42%)	\$613.08
07/13/06	Sell	\$124.00		(\$2,413.02)
07/31/06	Buy	\$127.85	(0.34%)	\$1,235.56
08/08/06	Sell	\$127.41		(\$977.50)
01/25/07	Buy	\$142.26	1.79%	\$1,888.38
02/02/07	Sell	\$144.81		(\$477.36)
10/08/07	Buy	\$155.02	(0.81%)	\$1,612.50
10/16/07	Sell	\$153.77		(\$999.75)
07/08/11	Buy	\$134.40	(2.82%)	\$0.00
07/18/11	Sell	\$130.61		(\$3,548.88)

Risk/reward certainly seems to favor the bears.

But there was one study that triggered tonight that suggested bullish implications. The SPX had move up strongly over the last few days and was strongly overbought short-term. With such a small decline on Monday the SPX is still strongly overbought as measured by the 2-day RSI. The 2-day RSI is a very sensitive indicator so it would take a very small decline from a very overbought position in order for it to remain above 90 on a down day. This is what happened on Monday. It therefore triggered the below study from the 3/19/10 letter, which I have updated.

SPX closes down but RSI(2) >90. Close > 200ma.  
Buy on close. Sell X days later. \$100k/trade. 1997 - 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	2,906.72	14	5	9	35.71	2,015.87	4,121.28	-796.96	-2,008.73	2.53	1.41	207.62
4	5,341.01	15	9	6	60.00	1,208.11	3,806.46	-922.00	-1,717.70	1.31	1.97	356.07
3	10,495.09	16	10	6	62.50	1,196.51	2,923.44	-245.01	-409.17	4.88	8.14	655.94
2	9,376.53	16	12	4	75.00	861.73	2,619.76	-241.05	-525.07	3.57	10.72	586.03
1	5,005.04	16	13	3	81.25	480.62	2,310.88	-414.34	-704.76	1.16	5.03	312.81

The stats here are all appealing over the 1-2 day period. Winning %, win/loss ratio, and profit factor all strongly favor the bulls. Below I have listed all instances assuming a 2-day holding period.

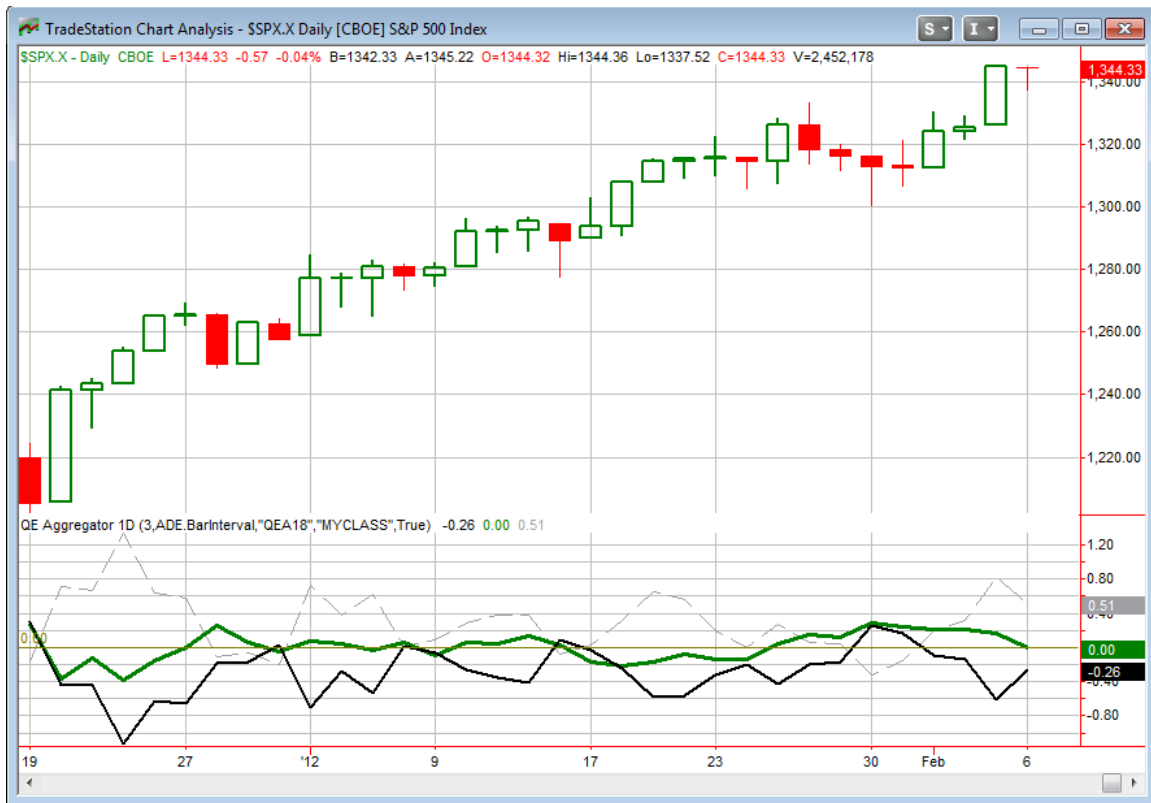
SPX closes down but RSI(2) >90. Close > 200ma.  
Buy on close. Sell 2 days later. \$100k/trade. 1997 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
12/31/97	Buy	\$970.43	0.69%	\$1,256.60
01/05/98	Sell	\$977.08		(\$484.10)
11/03/98	Buy	\$1,110.85	2.06%	\$2,072.70
11/05/98	Sell	\$1,133.68		(\$117.90)
12/27/99	Buy	\$1,457.09	0.44%	\$705.84
12/29/99	Sell	\$1,463.46		(\$293.08)
05/28/04	Buy	\$1,120.63	0.39%	\$664.83
06/02/04	Sell	\$1,124.99		(\$650.59)
11/15/04	Buy	\$1,183.82	(0.16%)	\$389.76
11/17/04	Sell	\$1,181.94		(\$714.00)
01/10/06	Buy	\$1,289.69	(0.28%)	\$401.17
01/12/06	Sell	\$1,286.06		(\$358.05)
08/30/06	Buy	\$1,304.27	0.52%	\$589.76
09/01/06	Sell	\$1,311.01		(\$138.32)
03/22/07	Buy	\$1,434.54	0.21%	\$300.15
03/26/07	Sell	\$1,437.50		(\$776.94)
07/17/09	Buy	\$940.38	1.51%	\$1,711.90
07/21/09	Sell	\$954.58		\$0.00
07/22/09	Buy	\$954.07	2.64%	\$2,674.88
07/24/09	Sell	\$979.26		(\$83.20)
08/24/09	Buy	\$1,025.57	0.25%	\$1,181.46
08/26/09	Sell	\$1,028.12		(\$388.00)
11/10/09	Buy	\$1,093.01	(0.53%)	\$1,124.76
11/12/09	Sell	\$1,087.24		(\$738.01)
03/08/10	Buy	\$1,138.50	0.62%	\$849.12
03/10/10	Sell	\$1,145.61		(\$313.20)
03/12/10	Buy	\$1,149.99	0.82%	\$884.94
03/16/10	Sell	\$1,159.46		(\$734.44)
03/18/10	Buy	\$1,165.83	(0.00%)	\$286.45
03/22/10	Sell	\$1,165.81		(\$1,100.75)
06/16/10	Buy	\$1,114.61	0.26%	\$569.60
06/18/10	Sell	\$1,117.51		(\$777.86)

Results here are impressive.

So while the majority of the studies tonight are suggesting a pullback, there is some conflict to keep things interesting.

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



With tonight's studies factored in the green Aggregator line closed just barely above 0 – and at an indistinguishable 0.003 level on the chart. 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 well 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 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 turn negative on Tuesday. This could certainly change if bullish evidence emerges. Meanwhile, the Differential Pivot will be 1,334.17 on Tuesday. This means the SPX will need to drop about 0.8% in order to turn the Differential Line positive.

Shortly before the close it appeared the Aggregator would trigger a short signal. The late rally moved the SPX very close to breakeven and ended up triggering the RSI(2) > 90 study, which kept expectations barely positive. Of course a short signal is looking more and more likely. Not only are expectations slated to turn negative tomorrow, but the QE Buying Power Index is going to turn negative on Wednesday and Thursday. If the market manages to hold up another day or 2 here we may get a relatively strong short

signal. So I am not going to rush into a counter-trend short position just yet. But I do anticipate doing so in the next few days if the market does not sell off right away.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 2/6 – bullish***

The intermediate-term outlook was last updated in the 2/6 letter. Use the link below to access it:

[2012-02-06 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**

*None*

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