

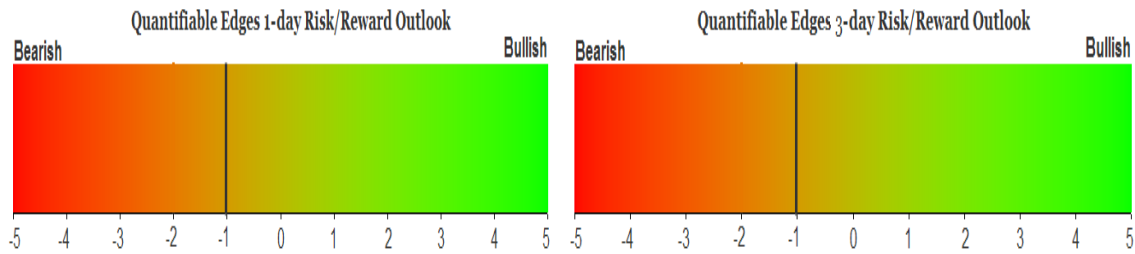
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 9, 2012

Volume 5 Issue 27

Market Overview



Signals Overview

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

Tonight's Research Points

- The strong move up in the VIX on a day the SPX closes at a 50-day high suggests a short-term downside edge.
- The QE Buying Power Index is not negative and the QE Short-term Buying Power Swing System triggered a short signal.

Short-term Outlook

The Bottom Line

Price is no longer considered overbought but I believe a pullback remains likely based on all the evidence we are now seeing. I will look to get short at the close on Thursday of the SPY does not sell off much.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
February 9, 2012	SPX 50-high. VIX up > 2.5%.	1-3 days	Bearish	
February 9, 2012	QE Buying Power Index System Short	1-5 days	Bearish	
February 8, 2012	Outside day to a 50-high on volume	1-2 days	Bearish	
February 8, 2012	50-high. Inside day. 50 high	1-2 days	Bearish	
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 6, 2012	Up Issues % > 75% 2 of 3. 10 high.	1-6 days	Bullish	2.60%
Active - Long Term				
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	
Dropped Tonight				
February 7, 2012	RSI(2) > 90 on down day > 200ma.	1-2 days	Bullish	

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

The Evidence

Like Monday, Tuesday saw a morning dip followed by an afternoon rally. This time the indices all closed positive, though. The SPX rose 0.2%, the Nasdaq was up 0.4%, and the Russell 2000 gained 0.1%. Breadth was mildly positive as the NYSE Up Issues % came in at 58% and the Up Volume % was 59%. Total NYSE volume came in a bit higher than the last two days.

Over the last few days we have seen evidence begin to build suggesting a pullback is near. That evidence was based on such things as tight ranges, volume patterns, and price action. Tonight we are seeing more bearish evidence emerge, but the premises are different. Tonight's studies are related to VIX action and POMO flows.

There were actually a few studies related to VIX action that appeared in the Quantifinder tonight. The one below was the most compelling. It last appeared in the 4/14/10 letter. New readers may wonder why I use a day-of-week filter with this study. The VIX has a natural tendency to fall on Fridays and rise on Mondays. Because of this I typically separate out those days from the rest of the week when conducting VIX-based studies. This particular study looks at large mid-week rises in the VIX during times the SPX is closing at a 50-day high. All results are updated.

SPX closes at a 50-day high and VIX rises at least 2.5% on Tuesday, Wednesday, or Thursday.
Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1998 - 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	-4,242.04	13	6	7	46.15	870.34	2,108.40	-1,352.01	-4,149.36	0.64	0.55	-326.31
4	-9,254.89	13	3	10	23.08	970.19	1,629.60	-1,216.55	-4,240.48	0.80	0.24	-711.91
3	-9,118.39	13	4	9	30.77	645.13	1,271.55	-1,299.88	-4,423.40	0.50	0.22	-701.41
2	-5,219.28	13	2	11	15.38	757.10	1,192.71	-612.13	-1,461.48	1.24	0.22	-401.48
1	-964.59	15	8	7	53.33	295.55	1,108.05	-475.57	-1,008.70	0.62	0.71	-64.31

100% of instances closed below their entry price
at some point in the next 4 days.

Instances are a bit low, but the numbers are quite lopsided. Below is a list of all instances assuming a 3-day exit strategy.

SPX closes at a 50-day high and VIX rises at least 2.5% on
Tuesday, Wednesday, or Thursday. Close > 200ma.
Buy on close. Sell 3 days later. \$100k/trade. 1998 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
03/25/98	Buy	\$1,102.00	(0.76%)	\$466.20
03/30/98	Sell	\$1,093.60		(\$1,078.20)
12/30/99	Buy	\$1,464.47	(4.44%)	\$920.04
01/04/00	Sell	\$1,399.42		(\$4,558.72)
03/23/00	Buy	\$1,527.35	(1.28%)	\$1,658.80
03/28/00	Sell	\$1,507.78		(\$1,316.90)
05/27/03	Buy	\$951.48	1.27%	\$1,459.50
05/30/03	Sell	\$963.59		(\$551.25)
12/30/03	Buy	\$1,109.64	1.13%	\$1,131.30
01/05/04	Sell	\$1,122.21		(\$410.40)
09/14/04	Buy	\$1,128.31	0.02%	\$190.96
09/17/04	Sell	\$1,128.55		(\$754.16)
12/30/04	Buy	\$1,213.55	(2.10%)	\$356.70
01/04/05	Sell	\$1,188.04		(\$2,309.12)
11/23/05	Buy	\$1,265.61	(0.64%)	\$250.43
11/29/05	Sell	\$1,257.48		(\$666.76)
03/15/06	Buy	\$1,303.02	0.16%	\$564.68
03/20/06	Sell	\$1,305.08		\$0.00
09/05/06	Buy	\$1,313.25	(1.09%)	\$0.00
09/08/06	Sell	\$1,298.92		(\$1,605.12)
01/16/07	Buy	\$1,431.90	(0.10%)	\$232.53
01/19/07	Sell	\$1,430.50		(\$530.61)
04/13/10	Buy	\$1,197.30	(0.43%)	\$1,379.46
04/16/10	Sell	\$1,192.13		(\$873.99)
01/18/11	Buy	\$1,295.02	(0.90%)	\$0.00
01/21/11	Sell	\$1,283.35		(\$1,829.52)

I see nothing here that would cause me to doubt the downside edge.

It was also notable tonight that the QE Buying Power Index dropped to -1. With the SPX closing in the top 20% of its 10-day range this triggered a short signal via the QE Short-term Buying power Swing System. Below are statistics using a time-based exit of entering upon similar circumstances.

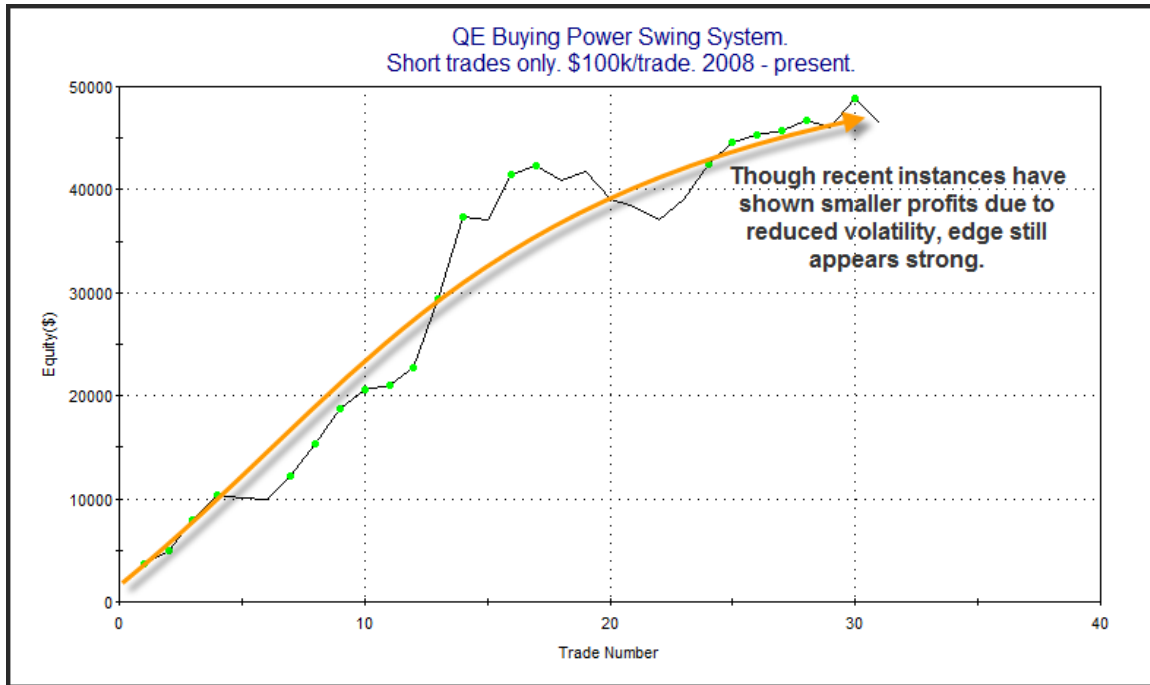
QE Buying Power Index <= 0. SPX closes in top 20% of 10-day range. Buy on close. Sell X days later. \$100k/trade. 2008 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-39,590.16	39	17	22	43.59	948.55	2,386.98	-2,532.52	-4,932.90	0.37	0.29	-1,015.13
4	-37,455.29	44	19	25	43.18	1,115.39	2,044.02	-2,345.91	-6,578.61	0.48	0.36	-851.26
3	-25,169.43	51	22	29	43.14	1,019.77	4,441.44	-1,641.53	-4,353.44	0.62	0.47	-493.52
2	-38,936.29	65	30	35	46.15	768.63	3,811.00	-1,771.29	-9,986.13	0.43	0.37	-599.02
1	-41,253.22	107	50	57	46.73	565.92	4,063.35	-1,220.16	-8,883.33	0.46	0.41	-385.54

The numbers here suggest a solid downside edge. This next set of results shows the short-side system trades assuming the exit criteria as laid out in the video / presentation slides on the QE Buying Power members page.

<http://www.quantifiableedges.com/members/qebuyingpower.php>

QE Buying Power Swing System. Short trades only. \$100k/trade. 2008 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$46,500.54	Profit Factor	5.76
Gross Profit	\$56,278.64	Gross Loss	(\$9,778.10)
Total Number of Trades	31	Percent Profitable	70.97%
Winning Trades	22	Losing Trades	9
Even Trades	0		
Avg. Trade Net Profit	\$1,500.02	Ratio Avg. Win:Avg. Loss	2.35
Avg. Winning Trade	\$2,558.12	Avg. Losing Trade	(\$1,086.46)
Largest Winning Trade	\$8,004.64	Largest Losing Trade	(\$2,799.05)

Despite the last instance being a loser the results remain strong. Below is an equity curve.



As I note on the chart, recent instances have shown smaller profits because the market has been in a less volatile state. Therefore moves are smaller. Still, the edge appears intact.

Also notable about current conditions is that the 3/10 Offset Historical Volatility Indicator came in at an extremely low 0.2 on Wednesday. I [first introduced this indicator in July of 2009](#). It essentially takes a short 3-day measure of Historical Volatility and compares that to the 10-day measure of 3-days ago. Low readings indicate there has been a contraction in volatility. High numbers indicate there has been an expansion. Anything at or below 0.25 is regarded as extremely low. Often after sharp contractions like this we see a volatility expansion take place.

In August of 2009 I published a study that found this condition created a favorable environment for trading Opening Range Breakouts (ORBs). A link to that study is below:

[Quantifiable Edges ORBs Study.pdf](#)

For anyone who is interested in seeing some techniques for actually trading these ORBs, there is a webinar from October 2010 on the subject on the videos page.

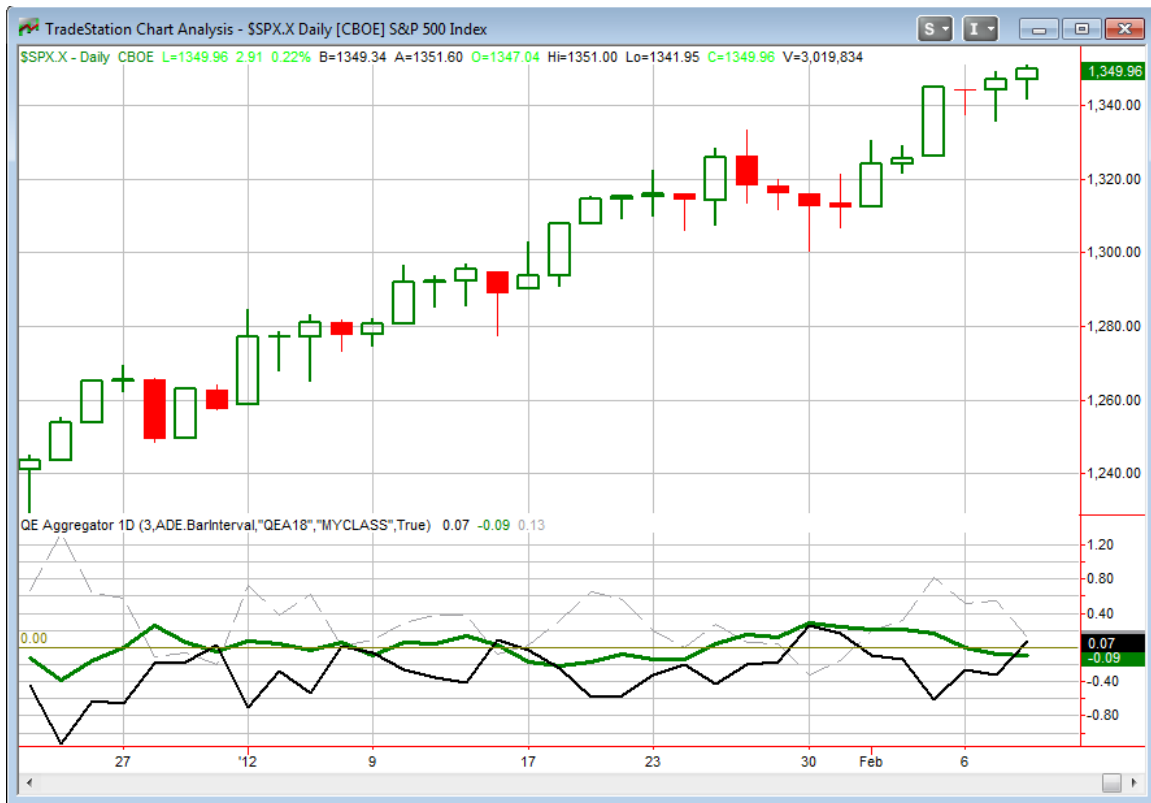
<http://www.quantifiableedges.com/members/videos.php>

It's important to note that the 3/10 Offset HV indicator predicts volatility, not direction. For direction I look to the Aggregator. The Aggregator is currently neutral, with the expectations side of it bearish. Under current circumstances I'd be a bit more inclined to short an ORB breakdown than a breakout. This would just be for a possible daytrade and is not something I will be tracking in the subscriber letter as an official trade idea.

Of further note, the 3/10 Offset HV Calculation is available as part of the "QE Indicators/Functions for Tradestation". Subscribers may download it to include on their own charts. A link to the Indicators page is below, where you may download the User Guide or the Tradestation ELD.

<http://www.quantifiableedges.com/members/qeindicators.php>

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



With tonight's studies factored in the green Aggregator line remained 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 rose back above 0. A positive Differential reading means the SPX has underperformed expectations over the last few days. So net expectations are bearish but the SPX is oversold 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 change from short to flat at the close.

It seems odd to say the SPX is "oversold" while it is at a 50-day high. The reason this is possible is that after the strong move on Friday it was anticipated by the studies that the market would continue up even more. Instead we have basically seen a consolidation over the last 3 days that has effectively worn off the overbought condition.

Based on the current active studies, expectations are scheduled to remain negative on Thursday. This is unlikely to change but could if strong bullish evidence emerges. Meanwhile, the Differential Pivot will be 1,349.43 on Thursday. This is extremely near Wednesday's closing price of 1,349.96. So any up (or very slightly down) close will again see the black Differential line flip sides. A selloff would keep the Differential Line positive.

So the short Aggregator signal from last night expired because the market is no longer considered “overbought”. Despite this I feel the opportunity to short remains a solid one. A large number of diverse short-term bearish studies are now active. I will therefore look for entry again on Thursday if we close above the Differential Pivot. I strongly considered taking a more aggressive approach, and even entering 2 lots rather than just 1. Ultimately, I decided I would rather err on the side of caution. I decided this because no matter how much short-term bearish evidence has built up in the last few days the trade remains both counter-trend and counter to my intermediate-term outlook. But while I’ll only be looking for 1 lot on Thursday, I may take on a 2nd lot as early as Friday morning.

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.

SPY – short 1/4 index position @ \$135.15 LIMIT ON CLOSE. Based on short-term outlook above. I will look to take a small short position if the SPY closes at this level, which is around the Differential Pivot. .

Current Open Trade Ideas

None

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