

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 10, 2012

Volume 5 Issue 28

## Market Overview



## Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Short	100% Short SPY	Short	Flat

## Tonight's Research Points

- VIX and SPX both closed up for a 2<sup>nd</sup> day in a row, suggesting a bearish outlook for the SPX – especially with it currently trading at a 50-day high.

## Short-term Outlook

### The Bottom Line

Lots of evidence is pointing south and the SPX is now overbought. I have a small short position that will add to it on Friday if I can get a favorable entry price.

## 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 10, 2012	SPX up VIX up 2 days. SPX 50-high.	1-3 days	Bearish	-1.40%
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%
<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***

Thursday was a generally quiet day with mixed results. The SPX rose 0.2%, and the Nasdaq was up 0.4%, but the Russell 2000 lost 0.4%. Breadth was also mixed as the NYSE Up Issues % came in just under 50% while the Up Volume % was 54%. Total NYSE volume dropped slightly from Wednesday’s level.

Thursday marked the 2<sup>nd</sup> day in a row where the SPX and VIX both closed up. And like Wednesday the VIX rose by more than 2.5%. In last night’s letter I showed how the combination of a 50-day closing high in the SPX and a VIX rise of over 2.5% had produced negative returns over the next 3-4 days.

Having the VIX rise over 2.5% on 2 days in a row while the SPX also rose is extremely unusual. Since 1998 I was only able to identify 3 other instances. While they were all lower 2 days later, just 3 instances isn’t enough to draw any conclusions from. Simply requiring 2 consecutive up closes for SPX and VIX is enough to suggest a bearish edge. But when you throw in a 50-day high close as I did in the 12/22/10 subscriber letter the downside edge is even more compelling. Below I have updated the results for that study.

SPX and VIX both close higher today and yesterday. SPX closes at a 50-day high. Buy SPX 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	-2,617.80	13	8	5	61.54	1,136.51	3,434.08	-2,341.97	-4,149.36	0.49	0.78	-201.37
4	-6,068.84	13	6	7	46.15	960.80	1,907.36	-1,690.52	-4,240.48	0.57	0.49	-466.83
3	-8,168.13	13	4	9	30.77	840.37	1,433.12	-1,281.07	-4,423.40	0.66	0.29	-628.32
2	-5,116.73	13	5	8	38.46	584.78	1,078.48	-1,005.08	-2,752.74	0.58	0.36	-393.59
1	-1,695.30	16	6	10	37.50	265.05	415.16	-328.56	-924.70	0.81	0.48	-105.96

**The only instance not to post a close below the entry price at some point in the next 3 days was 12/21/10.**

Despite the last one not working, the stats remain squarely bearish. Below I have listed all 13 instances assuming a 3-day exit strategy.

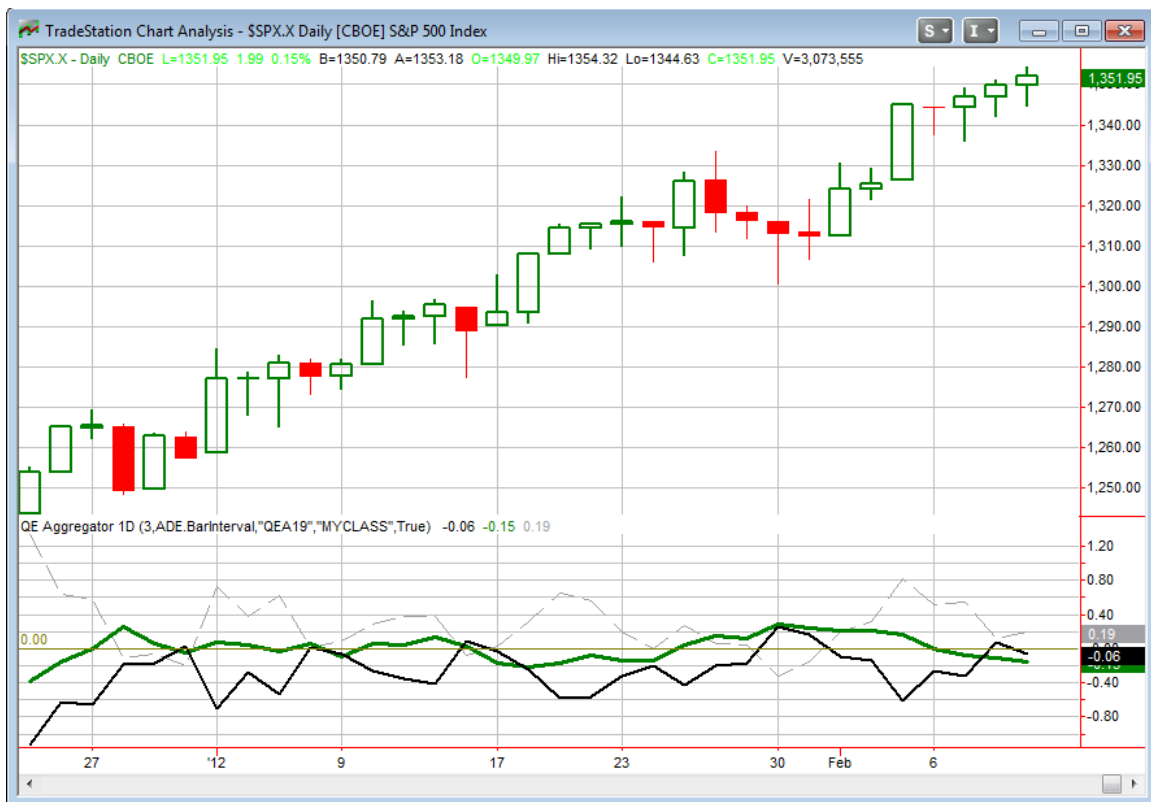
SPX and VIX both close higher today and yesterday. SPX closes at a 50-day high.  
Buy SPX on close. Sell 3 days later. \$100k/trade. 1998 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
12/30/99	Buy	\$1,464.47	(4.44%)	\$920.04
01/04/00	Sell	\$1,399.42		(\$4,558.72)
03/24/00	Buy	\$1,527.57	(1.25%)	\$458.90
03/29/00	Sell	\$1,508.52		(\$1,957.80)
05/28/03	Buy	\$953.22	1.45%	\$2,692.56
06/02/03	Sell	\$967.00		(\$726.96)
09/02/03	Buy	\$1,021.99	(0.06%)	\$712.95
09/05/03	Sell	\$1,021.39		(\$368.60)
12/30/03	Buy	\$1,109.64	1.13%	\$1,131.30
01/05/04	Sell	\$1,122.21		(\$410.40)
03/16/06	Buy	\$1,305.33	(0.62%)	\$421.80
03/21/06	Sell	\$1,297.23		(\$722.76)
09/18/06	Buy	\$1,321.18	(0.24%)	\$551.25
09/21/06	Sell	\$1,318.03		(\$675.75)
09/28/06	Buy	\$1,339.15	(0.38%)	\$54.02
10/03/06	Sell	\$1,334.11		(\$891.70)
04/18/07	Buy	\$1,472.50	0.57%	\$955.42
04/23/07	Sell	\$1,480.93		(\$538.01)
05/19/08	Buy	\$1,426.63	(2.26%)	\$0.00
05/22/08	Sell	\$1,394.35		(\$2,647.40)
04/23/10	Buy	\$1,217.28	(2.13%)	\$206.64
04/28/10	Sell	\$1,191.36		(\$2,924.12)
10/26/10	Buy	\$1,185.64	(0.20%)	\$326.76
10/29/10	Sell	\$1,183.26		(\$1,170.96)
12/21/10	Buy	\$1,254.60	0.23%	\$378.41
12/27/10	Sell	\$1,257.54		(\$246.48)

The record appears impressive. Risk/reward favors the bears nicely as well with the average drawdown (-1.4%) about 2x the average run-up (0.7%).

There were a couple of other discussion points in last night's letter that remain relevant tonight. One is the QE Buying Power Index remains low at -1. This should change on Friday, but the QE Buying Power Index System rules will allow it a few more days to reach its downside target before looking to cover. The other notable from last night that is still relevant is that the 3/10 Offset HV remains extremely low. This suggests a volatility expansion could occur. With the Aggregator now on a short signal I would personally only be interested in entering short on breakdowns of the opening range rather than looking to buy breakouts. More details on both of these concepts may be found in last night's letter.

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



With tonight's study 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 dipped back below 0 after just 1 day above it. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are bearish and the SPX is 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 change from flat to short at the close.

Based on the current active studies, expectations are again scheduled to remain negative on Friday. This is unlikely to change but could if strong bullish evidence emerges. Meanwhile, the Differential Pivot will be 1,348.25 on Friday. This is only about 0.3% below Thursday's close. So it won't take much of a selloff to turn the Differential back to positive and trigger an Aggregator System exit.

It is pretty rare to see so much bearish evidence build up – especially with the market at an intermediate-term high. With volume, Buying Power, price action and the VIX all pointing lower there is ample evidence that a selloff is likely. I took some short exposure at the close on Thursday and will add to the position on Friday if I am offered a favorable entry price.

***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 ¼ index position @ \$135.86 LIMIT ON OPEN. IF not filled, then cancel order and look to enter at \$136.86 LIMIT ON CLOSE. Based on short-term outlook above.***

### **Current Open Trade Ideas**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Price</b>	<b>% Gain/Loss</b>	<b>Stop</b>	<b>Notes</b>
SPY(1/4)(s)	2/9/2012	\$135.36	\$135.36	0.00%		shorted on close

*If SPX closes  $\leq 1,348.25$  (the Differential Pivot) I will exit half of my SPY position at the close. I don't want to cover the whole thing too quickly on a minor dip. I think we could get a few days of selling here and perhaps a decent sized pullback. Still it is a counter-trend trade and a close below the Differential Pivot would trigger an exit for the Aggregator System. So I'll close half. If Friday turns in to a sizable down day then I may send out an intraday update where I would cover the whole thing. More likely is that I will keep half and trail a stop on it early next week.*

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