

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 15, 2012

Volume 5 Issue 31

Market Overview



Signals Overview

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

Tonight's Research Points

- An unfilled gap up and a 20-day closing high followed by an unfilled gap down has often been followed by more downside.

Short-term Outlook

The Bottom Line

There is still a solid amount of short-term bearish evidence and the SPX is overbought. This means the Aggregator is suggesting a short-side edge. Intermediate-term bullish evidence and a strongly positive QE Buying Power Index have me a bit cautious. I will still look to a small short position if I can get a favorable entry.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
February 15, 2012	Unfill Gap Up 20-high then unfill gap dn	1-6 days	Bearish	-2.10%
February 14, 2012	20-high. Gap down. Gap up.	1-6 days	Bearish	-1.90%
February 13, 2012	60-day low SPY range > 200ma	1-6 days	Bearish	-2.15%
February 9, 2012	QE Buying Power Index System Short	1-5 days	Bearish	
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 6, 2012	Up Issues % > 75% 2 of 3. 10 high.	1-6 days	Bullish	2.60%
February 9, 2012	SPX 50-high. VIX up > 2.5%.	1-3 days	Bearish	
February 13, 2012	< 1% drop from 50-high. Bad breadth.	1-2 days	Bearish	-1.90%
February 7, 2012	Low vol drop from 50-high	1-6 days	Bearish	
February 13, 2012	8-day Avg Closing Range > 75%	1-2 days	Bearish	-1.40%
February 10, 2012	SPX up VIX up 2 days. SPX 50-high.	1-3 days	Bearish	-1.40%

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

The Evidence

A late-day surge ruined a perfectly good selloff. It shouldn't be surprising though since this is now the 9th day in a row that the SPY has closed in the top ½ of its daily range. The major indices finished mixed. The SPX lost 0.1% and the Russell 2000 was down 0.5%, while the Nasdaq gained 0.02%. Breadth was squarely negative as the NYSE Up Issues % came in at 36% and the Up Volume % was also 36%. Total NYSE volume rose just barely from Monday's level.

The SPY posted another unfilled gap today. This time it was down. This triggered the study below, which we saw just last week in the 2/7/12 letter. It examined times SPY posted an unfilled gap down immediately after an unfilled gap up and a 20-day high. Results are updated.

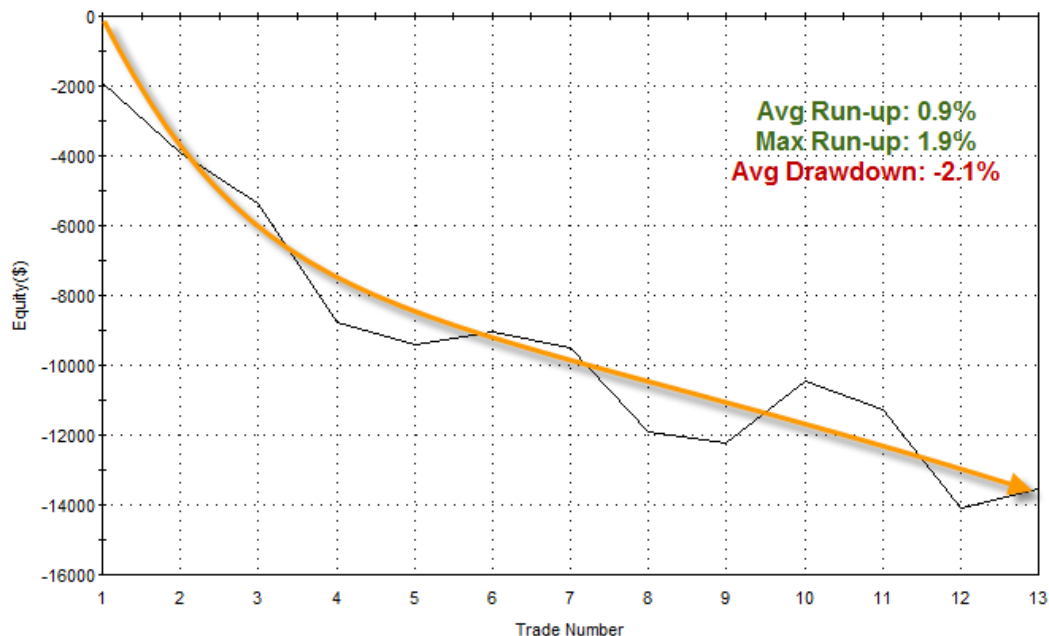
SPY posts an unfilled gap down after an unfilled gap up. Yesterday was the highest close in 20 days.
Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1999 - present.

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	-13,528.10	13	3	10	23.08	902.84	1,790.10	-1,623.66	-3,425.00	0.56	0.17	-1,040.62
5	-8,591.87	13	4	9	30.77	741.66	1,649.70	-1,284.28	-4,404.92	0.58	0.26	-660.91
4	-9,059.22	13	5	8	38.46	556.59	1,045.98	-1,480.27	-3,746.95	0.38	0.24	-696.86
3	-5,494.31	13	5	8	38.46	525.66	844.11	-1,015.33	-2,017.28	0.52	0.32	-422.64
2	-5,115.27	14	5	9	35.71	338.72	774.00	-756.54	-2,232.00	0.45	0.25	-365.38
1	-1,434.60	14	7	7	50.00	484.38	941.70	-689.32	-1,807.92	0.70	0.70	-102.47

All 14 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. In the 2/7/12 letter I listed all instances assuming a 6-day holding period. You may refer back to that letter if you wish to see them all listed. Tonight I instead elected to show the profit curve.

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Close > 200ma. Buy on close. Sell 6 days later. \$100k/trade. 1999 - present.



The curve here is fairly straight and has had a constant downslope. The risk/reward stats noted on the right hand side are especially compelling. I find it quite persuasive whenever the Avg Drawdown exceeds the Max Run-up.

I mentioned above that SPY has now closed in the top half of its daily range 9 days in a row. I looked to see how many other instances there were and how SPY performed following those instances. I found that there have only been 6 other instances. Unfortunately I found no strong tendencies following this setup.

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



The green Aggregator line again stayed squarely negative. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the black Differential Line also remained negative. 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 remain short at the close. This was indicated on the Systems page before the bell.

With no bullish short-term studies, expectations are again scheduled to remain negative on Wednesday. This is unlikely to change but could if strong bullish evidence emerges. Meanwhile, the Differential Pivot will be 1,336.06 on Wednesday. This is about 1.1% below Tuesday's close. While that isn't a huge drop, there hasn't been one that big yet in 2012. So a more likely scenario might be a multi-day drop.

While short-term evidence remains strongly bearish I still have some concerns. For one, the QE Buying Power Index is now at 3. Readings this high typically suggest downside is limited. Secondly, while short-term evidence is all bearish, nearly all of the intermediate-term evidence is bullish. And there is also a strong uptrend in play. Still, the Aggregator is negative and the SPX remains overbought, so I'll look to take advantage of this apparent downside edge. I will keep the position light, though and I will look for a favorable entry price on Wednesday.

Regarding the timing of Aggregator Trades and Signals

I have had a few people email me lately asking about taking Aggregator signal near the close versus waiting for the open and then using a limit price like I suggested in last night's letter. I've tested the 2 approaches in the past. And not only did I test them for the Aggregator system, but I have tested them on a number of mean-reversion systems over the years.

With regards to the Aggregator and with most systems I have tested on the following has held true:

- 1) Total net profits over a large sample size of trades has been larger using the entry at the close rather than waiting for the next day's open.
- 2) This makes sense because the only trades that are filtered out using a limit order the next day rather than buying the close are those trades that gap in the direction of the trade, never look back, and become winners.
- 3) Even using market on open orders (rather than limit orders) this typically holds true since the reversion will often begin during the overnight session.
- 4) While total profits are greater entering at the close, the average trade performs better when using "Next Day Limit" orders. This is because these trades will often see price improvements on gaps.

So whether you elect to take trades at the close or at the open is really a matter of personal preference. I will often take a portion of a position at the close to make sure I get some skin in the game, and then I will look to take the remaining the next day. The amount I enter at the close versus the open is mostly determined by how confident I feel in the setup.

Intermediate-term Outlook (2 weeks – 2 months)– updated 2/13 – bullish

The intermediate-term outlook was last updated in the 2/13/12 letter. Below is a link to that letter.

[2012-02-13 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 @ \$135.79 LIMIT ON OPEN. If not filled on open, cancel order and look to enter on close at a limit of \$135.20. Based on the short-term outlook above. I am looking for a favorable entry here. If price gaps up close to 0.5% then I will look to enter on the open. Otherwise, I will wait until the close to enter. I don't want to use a straight limit order and enter early in a possible rally day. With the market closing in the top portion of its range on a consistent basis lately, a limit on close order seems likely to give me a better fill.

Current Open Trade Ideas

None.

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